UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	)	**Docket No. ER01-889-002**
California Power Exchange Corporation	)	**Docket No. ER01-902-002**
San Diego Gas & Electric Company, Complainant,	)	
v.	)	**Docket No. EL00-95-021**
	)	**Docket No. EL00-98-020**
Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange,	)	**Docket No. EL00-104-004**
	)	**Docket No. EL00-107-005**
	)	**Docket No. EL01-1-005**
Respondents, et al.	)	

REQUEST FOR REHEARING,
MOTION FOR EXPEDITED CONSIDERATION
AND MOTION FOR CLARIFICATION OF
THE CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION

Pursuant to Rules 212 and 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212 and 385.713, the California Independent System Operator Corporation ("ISO") submits this Request for Rehearing, Motion for Expedited Consideration and Motion for Clarification with respect to the Order Granting Motion issued by the Commission in the above-captioned dockets on April 6, 2001.[1]

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[1] *California Independent System Operator Corp., et al.,* 95 FERC ¶ 61,024 (2001) **(**the "April 6 Order").

I. OVERVIEW

In the April 6 Order, the Commission, purporting to uphold the ISO's existing "creditworthiness requirements," stated that all ISO transactions involving third party suppliers must be backed by a creditworthy counter-party, including the ISO's procurement of Energy needed to serve unscheduled Load through the real-time Imbalance Energy market and through the issuance of emergency dispatch orders. This order is based on the false premise that the ISO Tariff provides credit requirements for ISO real-time energy transactions. No such requirements currently exist in the ISO Tariff, and the imposition of such new requirements would require the Commission to exercise its authority under Section 206 of the Federal Power Act ("FPA").[2] The Commission has failed to satisfy the procedural pre-requisites for imposing such new requirements.

The April 6 Order also suggests that the Commission's February 14, 2001 order in this proceeding applied to "all energy delivered to the loads through the ISO," but this is directly contradicted by the February 14 Order itself, which stated that creditworthiness issues related to the imbalance energy market were "unresolved."[3] To the extent credit requirements for real-time energy transactions or emergency dispatch orders are discussed at all in the February 14 Order, they are discussed in the context of future filings and future orders.

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[2] As discussed, *infra*, the ISO's filing in Amendment No. 36 was limited to temporarily waiving the prohibition on *scheduling* for Scheduling coordinators that fail to maintain an Approved Credit Rating or satisfy alternative credit requirements.

[3] *California Independent System Operator Corp. et al.,* 94 FERC ¶ 61,132 at 61,511 (2001) ("February 14 Order").

The ISO, a federal District Court and the Commission itself in a brief filed by the Court of Appeals for the Ninth Circuit (as well as Commission counsel in oral representations to that Court), all interpreted the Commission's order in the same way – that it left issues unresolved. Nothing in the February 14 Order placed the ISO on notice that the Commission intended to impose new credit requirements for ISO real-time energy transactions and certainly nothing indicates that the Commission had instituted the Section 206 proceeding which is a necessary pre-requisite to the imposition of such new requirements.

Moreover, even if the Commission had followed the appropriate procedures, the Commission's conclusion that such new requirements should be established is arbitrary, capricious, unsupported by substantial evidence and contrary to law. Requiring the ISO to obtain, in advance, a guarantee that a creditworthy counter-party will pay for real-time dispatch orders issued to maintain the balance of supply and demand on the ISO Controlled Grid, especially during System Emergencies, improperly places the private interests of suppliers of electricity above the public interest in ensuring that consumers are able to obtain electric service. Such requirements are therefore contrary to the Commission's primary duty to consumers under federal law. If the Commission does not grant rehearing of its determination in the April 6 Order that all real-time energy transactions, including real-time dispatch orders during System Emergencies, must be backed by a creditworthy counter-party, then the ISO's ability to fulfill its "primary obligation" of keeping supply and demand on the ISO Controlled Grid in balance without instituting widespread blackouts throughout

the State of California will be substantially impaired. Such widespread blackouts would create substantial public safety risks, and would be inconsistent with the obligations of a control area operator (*i.e.*, to utilize all available generation before curtailing load).

The ISO urges the Commission to recognize that limiting the ISO's ability to issue real-time dispatch instructions during the current crisis in the California electric markets – which has already forced into bankruptcy one utility that serves approximately 13 million customers – represents a profound misallocation of priorities. The April 6 Order inappropriately places greater importance on eliminating the risk of nonpayment for suppliers who are already earning tremendous profits in those markets than on ensuring continuity of service to California end-use customers. It therefore constitutes an abuse of the Commission's discretion under applicable law.

If the Commission does not grant rehearing on this issue, the Commission should clarify that its April 6 Order explicitly requires the ISO to cut electric service to consumers in California if no creditworthy counter-party agrees to back the real-time energy purchases or emergency dispatch orders needed to obtain energy to balance the Demand for electricity in California during System Emergencies. As explained below, such a requirement that the ISO curtail firm load if it cannot obtain credit support for all real-time dispatch orders is contrary to the ISO's legal obligations. To the extent the Commission intended the ISO to take some other action short of curtailing electric service to consumers in such a circumstance, the ISO requests that the Commission clarify what other steps it

believes the ISO can or should take to prevent the institution of blackouts in California under its April 6 Order.

II. BACKGROUND

A. Amendment No. 36

The ISO's proposed Amendment No. 36 was directed to a very specific problem (forward scheduling) raised by then-existing provisions of the ISO Tariff, and it had nothing whatsoever to do with real-time procurement of energy in the ISO's imbalance energy market or emergency dispatch instructions. The ISO filed Amendment No. 36 in this proceeding on January 4, 2001, after it became apparent that the financial well-being of Southern California Edison Company ("SCE" or "Edison") and Pacific Gas and Electric Company ("PG&E") was deteriorating rapidly. A downgrade in the credit ratings of those companies, and of the California Power Exchange ("PX"), which represented SCE and PG&E as a Scheduling Coordinator (and whose financial well-being in this capacity was linked to that of SCE and PG&E), was inevitable. Under Section 2.2.7.3 of the ISO Tariff, such a downgrade would preclude the ISO from accepting any advance Schedules submitted by the PX, representing those companies, or from one of the companies, unless the PX or company first posted financial security in accordance with Section 2.2.3.2. Section 2.2.3.2 provides in relevant part that a Scheduling Coordinator, Utility Distribution Company, or Metered Subsystem that does not maintain an Approved Credit Rating "shall be subject to the limitations on trading set out in Section 2.2.7.3" of the ISO Tariff. Under Section 2.2.7.3, the limitation is that such entities would be unable to have their Schedules accepted

by the ISO if they have not maintained the security required by Section 2.2.3.2. Due to their financial status, it was similarly apparent that PG&E, SCE and the PX were also unable to maintain such security.

In Amendment No. 36, the ISO proposed to waive, on a day-to-day basis, the limitations set forth in Section 2.2.7.3 on the ISO's ability to receive forward schedules from Scheduling Coordinators that are temporarily unable to satisfy the creditworthiness provisions of its Tariff in order to allow Edison and PG&E to continue to schedule with the ISO.

The Commission's "Order Addressing Creditworthiness Tariff Provisions Proposed by the California Independent System Operator and the California Power Exchange," *explicitly* resolved only the forward scheduling issues raised by the ISO's filing, and no more. That order, issued in this proceeding on February 14, 2001, conditionally accepted Amendment No. 36, subject to clarification and guidance. In particular, the Commission said that it would:

> accept the amendments to the extent they allow PG&E and SoCal Edison to continue to *schedule* transactions from generation and over transmission they own to serve their own load. We deny the amendments to the extent they allow PG&E and SoCal Edison to continue to *schedule* transactions from third-party suppliers without adequate assurance of payment. We clarify that PG&E and SoCal Edison may continue to *schedule* third-party transactions if they obtain financial backing from creditworthy counterparts. These actions, in the aggregate, should help in maintaining the reliability of system operations and in encouraging entry of lower-cost supply into California markets.

February 14 Order, 94 FERC at 61,505 (emphasis added). In response to the ISO's request for guidance going forward, the Commission stated that the relaxation on the scheduling restrictions with regard to third parties would be

acceptable if combined with appropriate support from creditworthy counter-parties. *Id.* at 61,511. The Commission directed the ISO to make certain compliance changes to the Tariff provisions proposed in Amendment No. 36 and to submit a filing addressing credit support for third-party transactions.[4]

On February 22, 2001, various Participating Generators[5] in California (hereafter the "California Generators") filed a motion alleging that the ISO had failed to comply with the February 14 Order and requested that the Commission issue an emergency order requiring the ISO to obtain a creditworthy guarantor for all real-time energy transactions, including emergency dispatch orders. The ISO filed its Answer to this request on February 27, 2001.[6]

In its April 6 Order, the Commission indicated that it was granting the California Generators' motion, declaring that:

> The ISO has misinterpreted our order. Contrary to the ISO's interpretation, the February 14 Order did not exempt any transactions from the requirement to have in place a creditworthy buyer. Instead our order provided third-party suppliers assurances of a creditworthy buyer for all energy delivered to the loads through the ISO

April 6 Order, 95 FERC at 61,081. The Commission directed the ISO to "comply

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[4] The ISO submitted such a filing in this proceeding on March 1, 2001 ("March 1 filing"). On April 26, 2001, the Commission issued a letter order in this proceeding directing the ISO to submit additional modifications with respect to "creditworthiness transactions for unscheduled transactions." The ISO is currently preparing its response to that letter order.

[5] Participating Generators are Generators that have signed contracts with the ISO under which they have agreed to be bound by the ISO Tariff in exchange for the opportunity to schedule transactions over the ISO Controlled Grid.

[6] In that Answer, the ISO noted that "[t]he California Generators' filing amounts to an argument that the ISO Tariff's requirement that they respond to emergency dispatch orders is unjust and unreasonable unless they are given iron-clad assurance of payment for their energy. The California Generators may make such a claim, but to do so they must file a complaint under Section 206 of the FPA, rather than seek to have the Commission rule that it already has made the desired finding *sub silentio* in the February 14 Order." February 27 Answer at 13.

with the February 14 Order" consistent with its discussion in the April 6 Order.

B. ISO Implementation of the April 6 Order.

Although the ISO does not believe that the necessary procedures have been followed to impose the new requirements announced in the April 6 Order, the ISO has nonetheless been engaged in an effort to determine how it could satisfy such requirements while simultaneously fulfilling its primary obligation to maintain the balance of supply and demand on the ISO Controlled Grid and to comply with regional reliability criteria. Reconciling such new requirements with the ISO's core obligations requires the ISO to take into account the deteriorating financial condition of the major California public utilities.

As the Commission is aware, PG&E filed for Chapter 11 bankruptcy protection several hours before the Commission issued the April 6 Order. SCE also remains in significant financial distress due to the ongoing California energy crisis. Although PG&E may at some future point be authorized by the bankruptcy court to cover the costs of forward energy transactions for its customers, there remains significant uncertainty as to the likelihood that either of these entities might be considered a "creditworthy" entity for the foreseeable future. In fact, on May 2, 2001 PG&E filed an Application for Preliminary Injunction in the United States Bankruptcy Court, Northern District of California contending that the ISO may not, after April 6, make purchases for its account.

The State of California has authorized the California Department of Water Resources ("CDWR" or "DWR") to cover some purchases of energy made to serve the customers of these utilities, both through forward contracting and

through short-term purchases of electricity. CDWR has agreed to serve as a creditworthy counter-party for the real-time energy transactions and emergency dispatch instructions that are needed to serve the end-use customers of PG&E and SCE, subject to certain conditions. No other entity is willing to do so.

On April 13, 2001, the ISO issued a notice to all Market Participants describing the terms under which CDWR has agreed to serve as a counter-party to such transactions.[7] As explained in the April 13 Market Notice, CDWR "will assume financial responsibility for all purchases by the ISO in its ancillary services and imbalance energy markets based on bids or other offers determined to be reasonable" and "[s]uch determination of reasonableness will be made by DWR on a case by case basis."

CDWR has informed the ISO that, to the extent all available energy bids (including energy bids associated with Ancillary Services and Supplemental Energy bids) are at or below a price level CDWR determines to be reasonable, CDWR will also cover the costs of those bids. CDWR has also agreed to cover the costs of emergency dispatch orders "to the extent not paid or payable by another Qualified Party [*i.e.,* another party meeting the credit standards set forth in the ISO Tariff]." If suppliers of electricity submit bids above the level CDWR determines to be reasonable, however, CDWR will not cover the cost of all available bids. Since no creditworthy entity has agreed to provide financial support for such high bids, the April 6 Order would apparently prevent the ISO from accepting such bids on behalf of load-serving entities in California.

[7] That notice ("April 13 Market Notice") is provided as Attachment B to this filing.

Moreover, if the ISO is required to leave such bids "standing" because of the lack of a creditworthy counter-party, the ISO would be unable to issue emergency dispatch orders to balance supply with real-time demand, since that authority depends upon bids being unavailable.[8] If the ISO is unable either to accept real-time energy bids or to issue emergency dispatch orders to satisfy demand for electricity in real-time, the April 6 Order would force the ISO to black out customers in California, notwithstanding the availability of resources to satisfy the demand for electricity.

III. SPECIFICATIONS OF ERROR

In compliance with Rule 713(c)(1) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.7(c)(1), the ISO respectfully submits that the Commission erred in the following respects in the April 6 Order:

> 1. The Commission erred in concluding that either its February 14 Order or its April 6 Order could serve as the basis for imposing creditworthiness requirements for real-time energy transactions and emergency dispatch instructions. Neither the Commission nor any other party followed the necessary or appropriate procedures for imposing such new requirements, including the requirements of Section 206 of the Federal Power Act.
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> 2. The Commission improperly ruled that the ISO must obtain a guarantee in advance that a creditworthy counter-party will pay for real-time dispatch orders issued to maintain the balance of supply and demand on the ISO Controlled Grid during System Emergencies. Such a ruling may force the ISO to curtail electric service to consumers in California when there is energy available to serve them, and would therefore place the private interests of suppliers of electricity over the public interest of ensuring that customers receive electric service. Such an action is contrary to federal law and represents an abuse of the Commission's discretion. Moreover, it circumvents the generators responsibility to seek to modify the ISO Tariff pursuant to Section 206 of the Federal

[8] *See, e.g., California Independent System Operator Corp.*, 90 FERC ¶ 61,006, at 61,011 (2000).

Power Act if they are dissatisfied with the current payment provisions or allocation of risk.

IV. REQUEST FOR REHEARING

A. The Commission Failed To Follow the Proper Procedures to Establish New Creditworthiness Requirements For Real-Time Energy Transactions.

In the April 6 Order, the Commission suggests that "the ISO has misinterpreted our [February 14] order" and states that "our order provided third-party suppliers assurances of a creditworthy buyer for all energy delivered to the loads through the ISO." April 6 Order, 95 FERC at 61,080. The implications of the April 6 Order – that the February 14 Order imposed a requirement on the ISO to make arrangements with a creditworthy counter-party before dispatching resources to meet real-time energy demand – are contrary to the procedural posture of this case and the nature of the ISO Tariff provisions relating to creditworthiness. The February 14 Order did not purport to and the April 6 Order is insufficient to impose such new credit requirements for real-time transactions.

1. The ISO Tariff Does Not Require the ISO to Obtain Guarantees of Payment Prior To Dispatching Energy Needed To Maintain the Balance of Supply and Demand in Real-Time.

The April 6 Order is based on the false premise that the ISO is already subject to some sort of requirement to obtain credit backing before dispatching energy in real-time, whether it be pursuant to bids to provide Imbalance Energy or the ISO's authority to issue emergency dispatch orders. The April 6 Order does not suggest where such a requirement originates, and for good reason – such a requirement does not exist. No provision in the ISO Tariff or in any

previous Commission order limits the ISO's ability to procure energy in real-time due to a Scheduling Coordinator's failure to satisfy the applicable creditworthiness requirements.

The April 6 Order states that:

> To the extent the February 14 Order references only scheduled transactions, the Commission did not intend to exempt any third-party transactions from requiring a creditworthy buyer. The ISO's creditworthiness requirements apply whether transactions are scheduled or not, and we created no exception in our February 14 Order.

Id. at 61,080 n.7. Yet that order cites no provision of the ISO Tariff imposing "creditworthiness requirements" on unscheduled (*i.e.,* real-time) transactions. No such provision exists. The Commission was far more accurate in its description of the ISO Tariff creditworthiness provisions in its February 14 Order: "[t]he creditworthiness requirements in the ISO tariff apply not only when a UDC is *scheduling* delivery of power purchased from a third party, but also when a UDC or its Scheduling Coordinator is *scheduling* its own generation and using its own transmission resources that are now controlled by the ISO." February 14 Order, 94 FERC at 61,510. The only *mandatory* restrictions for failure of a Scheduling Coordinator to satisfy creditworthiness requirements are the forward scheduling restrictions set forth in Section 2.2.7.3. It is these forward scheduling restrictions, and only these forward scheduling restrictions, that the ISO proposed to modify in Amendment No. 36.

This fact was confirmed by a recent United States District Court decision. On March 21, 2001, Judge Frank C. Damrell, Jr. of the United States District Court, Eastern District of California issued an "Order Granting Preliminary

Injunction" in a proceeding addressing issues related to the instant proceeding, *California Independent System Operator Corp. v. Reliant Energy Services, Inc. et al.,* No. Civ. S-01-238 FCD/JFM ("March 21 District Court Order"). In that proceeding, the ISO sought and obtained a preliminary injunction requiring Participating Generators to comply with emergency dispatch orders. In the order granting the preliminary injunction, Judge Damrell also denied a motion filed by Reliant Energy Services, Inc., *et al.* ("Reliant") to dismiss the ISO's action.

Reliant's motion was premised on the argument that the February 14 Order showed that the creditworthiness requirements of the ISO Tariff apply to real-time energy transactions, including compliance with emergency dispatch instructions. In the March 21 District Court Order, which is provided as Attachment B to this filing, Judge Damrell provided an extensive analysis of the applicable ISO Tariff provisions and the February 14 Order and concluded that neither expressly addressed creditworthiness requirements with respect to the real-time market or emergency dispatch orders.[9] Specifically, the District Court held:

> Reliant interprets the [February 14] FERC order to hold that the creditworthiness provisions of the ISO Tariff apply to all real-time transactions, including emergency dispatch instructions. They plainly do not.

March 21 District Court Order at 14.[10]

Under Section 2.2.4.5 of the Tariff, the ISO does have the *authority* but not the *obligation* to terminate a Scheduling Coordinator Agreement with a

[9] *See* March 21 District Court Order at 12-17.

Scheduling Coordinator that has failed to satisfy the credit requirements of Section 2.2.3 upon notice and a failure to remedy the default. Such an action would not be helpful in the current crisis because it could leave most of the customers in California unrepresented by a Scheduling Coordinator to whom the costs of serving those customers could be allocated. In fact, if the ISO is unable to identify a new Scheduling Coordinator willing to represent the customers of a terminated Scheduling Coordinator, Section 2.2.4.7.2 of the ISO Tariff provides that those customers must be served by the Utility Distribution Company in whose Service Areas those customers are located. Thus, the obligation to serve those customers would still fall to non creditworthy entities: specifically, PG&E and SCE.

The ISO recognizes that, *in the normal course of business*, the creditworthiness requirements for Scheduling Coordinators found in the ISO Tariff would provide certain assurances that suppliers would be paid for all transactions involving the use of the ISO Controlled Grid.[11] The forward scheduling restrictions of Section 2.2.7.3 would provide sufficient incentives for Scheduling Coordinators to maintain the appropriate credit ratings. These provisions, however, do not restrict the ISO's ability to satisfy its primary obligation to maintain the balance of supply and demand on the ISO Controlled Grid in real-time. There is no language in the ISO Tariff that requires the ISO to

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[10] Although this order has since been stayed by the U.S. Court of Appeals for the Ninth Circuit, that stay was issued due to jurisdictional concerns unrelated to the merits of the District Court's analysis of the ISO Tariff.

[11] As discussed below, the current conditions in California are far from normal. In the context of this extraordinary climate, the Commission must balance the public interest in ensuring continuity of service to consumers against the desire of suppliers to obtain guaranteed payment for each and every real-time energy transaction.

obtain a creditworthy backer prior to obtaining the real-time energy needed to serve end use customers in California. Such an obligation therefore can only be imposed if the statutory requirements of the FPA are satisfied.

2. The Section 206 Requirements Necessary to Impose New Credit Requirements on the ISO Have Not Been Satisfied.

The issue of the ISO's creditworthiness requirements has been raised in several pleadings in this proceeding: a specific and narrow Tariff amendment filed by the ISO and two motions filed by suppliers of electricity. The ISO's creditworthiness requirements have also been addressed in two Commission orders. At no time, however, have the requirements necessary to impose *new* credit requirements for the ISO's procurement of energy on behalf of load-serving entities or to *modify* the ISO's existing credit requirements been satisfied.

a. The Commission Did Not Provide Notice That It Intended To Initiate Section 206 Proceedings.

Section 206 of the Federal Power Act establishes clear procedures for the Commission, upon its own motion or upon filing of a complaint, to modify any existing "rate, charges or classifications" of a public utility like the ISO or any "rule, regulation, practice or contract affecting such rate, charge or contract" or to impose any new "rate, charge, classification, rule, regulation, practice or contract." Section 206(a) requires that the Commission first determine that the existing "rate, charge, classification, rule, regulation, practice or contract" is "unjust and unreasonable" and then determine the "just and reasonable rate, charge, classification, rule, regulation, practice or contract to be thereafter observed."

Section 206(b) of the FPA requires that:

> Whenever the Commission institutes a proceeding under this section, the Commission shall establish a refund effective date. In the case of a proceeding instituted on complaint, the refund effective date shall not be earlier than the date 60 days after the filing of such complaint nor later than 5 months after the expiration of such 60-day period. In the case of a proceeding instituted by the Commission on its own motion, the refund effective date shall not be earlier than the date 60 days after the publication by the Commission of its intention to initiate such proceeding nor later than 5 months after the expiration of such 60-day period.

Section 206(b) also provides that, "[I]n any proceeding under this section, the burden of proof to show that any rate, charge, classification, rule, regulation, practice or contract is unjust and unreasonable, unduly discriminatory, or preferential shall be on the Commission or the complainant."

Since the ISO Tariff's existing credit requirements do not limit the ISO's ability to procure energy in real-time due to a Scheduling Coordinator's failure to satisfy the applicable creditworthiness requirements, such a limitation can only be imposed after the requirements of Section 206 have been satisfied. None of those requirements has been satisfied in the instant proceeding: no complaint has been filed and the Commission has not provided notice that it is instituting Section 206 proceedings; no refund effective date has been established; and the Commission has not made a finding that the ISO Tariff's lack of credit support requirements for real-time transactions are unjust and unreasonable in the current circumstances.

The filing of Amendment No. 36 to the ISO Tariff, pursuant to Section 205 of the FPA, is insufficient to enable the Commission to circumvent the requirements of Section 206. As noted above, Amendment No. 36 addressed

only the narrow question of whether the ISO could waive the specific penalties set forth in Section 2.2.7.3 of the Tariff, namely, the denial of the right of Scheduling Coordinators to submit Schedules if they fail either to maintain an Approved Credit Rating or to post security in accordance with Section 2.2.3.2 of the ISO Tariff. By definition, real-time energy is not scheduled. Therefore, the ISO's proposal in Amendment No. 36 did not, in any way, address real-time energy transactions. Moreover, no party can circumvent the requirements of Section 206 by raising new issues in response to a Section 205 filing.[12]

Nothing in the Commission's February 14 Order provided notice that the Commission was instituting Section 206 proceedings to consider the justness and reasonableness of the ISO Tariff provisions relating to creditworthiness or the need for credit support with respect to ISO real-time energy transactions. Instead the issues resolved in the February 14 Order, like Amendment No. 36 itself, were expressly limited to the impact of the credit provisions of the ISO

[12] *See MidAmerica Energy Company*, 83 FERC ¶ 61,084, at 61,417 (1998) (denying request on issue in Section 205 proceeding as being beyond the scope of the proceeding, and stating that, to pursue the issue, the requesting party would have to file a separate complaint under Section 206). *See also Delmarva Power & Light Company, et al.*, 91 FERC ¶ 61,046, at 61,167 (2000) (same Commission direction on issue raised that was beyond the scope of a Section 203 proceeding).

Tariff on scheduling rights.[13] Although the Commission expressed the hope that its order would reduce the frequency with which the ISO must issue emergency real-time dispatch orders to meet unscheduled demand, it stated that creditworthiness issues regarding the residual load served in the ISO's real-time energy market remained "unresolved":

> Under our order, the ISO can continue to accept the UDCs' schedules to supply their load with their own resources, and DWR's authority to purchase on behalf of the UDCs is acceptable. Thus, *the unresolved creditworthiness issues relate to the UDCs' residual load that is served through the ISO's imbalance energy market*. Under current conditions, there is a bid insufficiency in the ISO's energy imbalance market causing the ISO to issue emergency dispatch instructions in order to meet this residual load and balance the system. By maintaining appropriate creditworthy standards that ensure payment for services by a creditworthy counterparty such as DWR, this order should increase the supply in the energy imbalance market *and reduce the need for emergency dispatch instructions*.[14]

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[13] The Commission recognized the limited nature of the proceeding in the February 14 Order, ultimately ruling:

> We accept the amendments to the extent they allow PG&E and SoCal Edison to continue to *schedule* transactions from generation and over transmission they own to serve their own load. We deny the amendments to the extent they allow PG&E and SoCal Edison to continue to *schedule* transactions from third-party suppliers without adequate assurance of payment.

February 14 Order, 94 FERC at 61,505 (emphasis added). "The emphasis on scheduling rights also permeated the Commission's rationale:

> The creditworthiness requirements in the ISO tariff apply not only when a UDC is *scheduling* delivery of power purchased from a third party, but also when a UDC or its Scheduling Coordinator is *scheduling* its own generation and using its own transmission resources that are now controlled by the ISO. . . . We also reject application of the ISO's proposed Amendment No. 36 beyond the UDCs and their Scheduling Coordinators *self-scheduling* their own generation and accessing their own transmission facilities.

Id. at 61,510 (emphasis added).

[14] February 14 Order, 94 FERC at 61,511.

As noted above, the February 14 Order did require the ISO to submit a subsequent filing "to incorporate provisions for an acceptable form of a credit support that provides adequate assurances of payment for third-party suppliers," and to modify the provisions proposed in Amendment No. 36. Because Section 206 proceedings raising the issue of credit support for real-time energy transactions had not been initiated, the ISO could only conclude that this filing must be limited to the scope of its own Section 205 filing, *i.e.*, that the filing required by the February 14 Order was to address the application of the ISO Tariff limitations on forward scheduling for Scheduling Coordinators that fail to satisfy credit requirements. The ISO's March 1, 2001 filing to comply with the February 14 Order was based on this conclusion. The April 6 Order and the letter order issued by the Commission on April 26 suggest that the Commission now believes that this filing should address requirements beyond those currently found in the ISO Tariff or addressed in Amendment No. 36. The Commission cannot, however, circumvent the requirements of Section 206 by requiring a public utility to undertake new obligations when it makes a "compliance" filing in response to a Section 205 order. In order to impose new requirements upon the ISO or to direct the ISO to modify existing Tariff provisions, the Commission must formally institute Section 206 proceedings, with the requisite notice, refund effective date, and based upon a finding of unjust and unreasonable rates, charges, classifications, rules, regulations, practices or contracts [15] It has not

[15] *See, e.g., Panhandle Eastern Pipe Line Company v. FERC*, 613 F.2d 1120 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 889 (1980) (Commission cannot impose condition that circumvents prospective-only relief mechanism).

done so here.

The February 14 Order did address a motion for clarification filed by Dynegy in Docket Nos. EL00-95 *et al.* raising various issues relating to creditworthiness provisions of the ISO Tariff. The Commission, however, denied Dynegy's motion for clarification except insofar as its conditional acceptance of Amendment No. 36 and its requirement for a subsequent filing by the ISO addressed some of the concerns raised by Dynegy.[16] Dynegy's motion was not a complaint and therefore did not initiate a Section 206 proceeding related to credit support issues. The Dynegy motion was filed in an ongoing proceeding that includes a number of current Section 206 proceedings. None of those existing 206 proceedings raise the need for credit support with respect to real-time energy transactions. The mere fact that Dynegy raised this issue in a 206 case involving other issues (specifically, the justness and reasonableness of rates in California wholesale electric markets) is not enough to satisfy the requirements of Section 206 of the FPA in order to change the ISO Tariff's credit support requirements. For example, numerous parties have filed pleadings related to rates in the Western Interconnection in Docket Nos. EL00-95 *et al.*, but

[16] "We deny Dynegy's additional requests for rehearing." February 14 Order, 94 FERC at 61,511. In the February 14 Order, the Commission also indicates that it will address, in a future order, the arguments Dynegy had raised as to whether the penalties for generators that fail to comply with real-time dispatch instructions issued during a System Emergency should apply when purchasers fail to meet creditworthiness requirements. February 14 Order, 94 FERC at 61,511. This action further demonstrates that the February 14 Order resolved only creditworthiness requirements that apply to forward scheduled transactions and left as unresolved any issues related to credit support for real-time transactions. This is the only rational explanation for the reservation of the Dynegy issue; if credit support for real-time transactions already was required, the issue raised by Dynegy would have been resolved.

the Commission has determined that it could not act on those pleadings until it recently initiated a separate Section 206 proceeding to address those issues.[17]

Nor does the California Generators' February 22 motion satisfy the requirements of Section 206. The California Generators did not file a complaint against the ISO alleging that failure to provide credit guarantees for each and every real-time energy transaction was unjust and unreasonable. Instead, they sought to enforce a requirement which, for reasons explained above, does not exist in the ISO Tariff and could not have been imposed by the February 14 Order.

b. The April 6 Order Contradicts the Commission's Own Statements.

In the April 6 Order, the Commission now asserts that the February 14 Order did impose creditworthiness requirements for ISO real-time energy transactions. Setting aside for a moment the fundamental flaw that the statutory pre-requisites for establishing such a new requirement have not been satisfied, this assertion flies in the face of the plain language of the February 14 Order as well as the statements of the Commission's own counsel before the Ninth Circuit Court of Appeals.

As noted above, the United States District Court for the Eastern District of California reached the same conclusion that the ISO did in reading the February 14 Order – that the February 14 Order did not resolve creditworthiness issues with respect to the real-time energy market or emergency dispatch instructions.

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[17] *See San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, et al.*, 95 FERC ¶ 61,115 (2001).

The District Court's analysis focussed on the specific language of the February 14 Order, noting that the operative language of the order is limited to "schedules" and "scheduling," and observed that the February 14 Order provides that there are "unresolved creditworthiness issues [that] relate to the UDC's residual load that is served through the ISO's imbalance energy market."[18] In addition, a brief filed by counsel for the Commission in the Ninth Circuit fully supports the conclusion reached by the District Court that the February 14 Order was not intended to resolve any issues related to the credit support needed for real-time ISO energy transactions:

> The Commission stated in its February 14, 2001 order that it would address the applicability of creditworthiness provisions to emergency dispatch instructions in a future order, and the matter is currently under consideration by the Commission.[19]

This representation, as well as the plain language of the February 14 Order, belie the Commission's suggestion that the February 14 Order was intended to resolve issues concerning the credit support for real-time energy transactions.[20] At most, the Commission provided some notice that it intended to address these issues in a future order. The first order that actually purported to impose credit support requirements for ISO real-time energy transactions was the April 6 Order.

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[18] *See* March 21 District Court Order at 12-17.

[19] April 4, 2001 Memorandum in Response to April 3, 2001 Order at 8, Appeal No. 01-15528 (Attachment C to this filing). In open court, the Commission's Solicitor further represented to the Court that the real-time creditworthiness issue was pending before the Commission and would soon be addressed.

[20] In an order issued in *California Independent System Operator Corp. v. Reliant Energy Services, Inc. et al.,* No. Civ. S-01-238 FCD/JFM on April 9, 2001, the United States District Court, Eastern District of California noted that the Commission's assertion that real-time creditworthiness issues were already resolved in the February 14 Order was "Contrary to statements made in its February 14, 2001 order and representations to the Ninth Circuit made only days ago." This order (the "April 9 District Court Order") is provided as Attachment D to this filing.

The April 6 Order cannot impose such new requirements, however, until the minimum requirements of Section 206 – the filing of a complaint or issuance of a formal notice; the establishment of a refund effective date; and a finding that current ISO creditworthiness requirements are unjust and unreasonable – have been satisfied. The Commission should therefore grant rehearing and find that the ISO is not subject to a requirement to obtain a guarantee in advance that a creditworthy counter-party will pay for real-time dispatch orders issued to maintain the balance of supply and demand on the ISO Controlled Grid unless or until the requirements of Section 206 of the FPA for imposing such a new obligation have been satisfied.

B. Requiring Credit Guarantees for All Real-Time Energy Transactions Improperly Places the Private Interests of Energy Suppliers Over the Public Interest of Maintaining Electric Service to Consumers.

Leaving aside the Commission's failure to institute the appropriate Section 206 proceedings, imposition of a requirement that the ISO obtain, in advance, a guarantee that a creditworthy counter-party will pay for all real-time dispatch orders issued to maintain the balance of supply and demand on the ISO Controlled Grid is not just and reasonable. Such a requirement would impede the ISO's ability to satisfy reliability requirements during periods of insufficient generation, *i.e.*, System Emergencies. Because the ISO is unable to guarantee payment for each and every dispatch instruction that might be issued pursuant to real-time energy bids or emergency dispatch instructions during the current crisis, such a requirement would eliminate the ISO's ability to rely upon such real-time dispatch of generating units during System Emergencies, would lead to

violations of regional reliability criteria and would result in interruptions of service to consumers.[21] Such a limitation on the ISO's ability to exercise its real-time and emergency dispatch authority would create a situation where there is only one option available to maintain the stability of the ISO Controlled Grid when there is insufficient Generation committed to satisfy demand: the curtailment of firm Load in California, *i.e.*, the implementation of blackouts in California with all the attendant risks to public health and safety. Such a requirement would inappropriately place a higher priority on assuring that suppliers of electricity receive payment for every MW of electricity they generate than on the continuity of electric service to the millions of citizens in California. In short, the Commission is directing the ISO to turn out the lights in California if the generators are not guaranteed payment. Such a result cannot be justified.

1. The Federal Power Act Requires the Commission to Place Primary Importance on the Impact of its Actions on Consumers.

The Commission is charged with implementing the provisions and policies of the Federal Power Act. Congress' primary purpose in enacting the Federal Power Act was protection of consumers from excessive rates and inadequate service. Where the interests of private utilities conflict with the interests of consumers, the Federal Power Act and applicable precedent require that the

[21] In real-time, when the ISO is struggling to keep supply and demand in balance, it does not know for whose "account" it is accepting energy bids or issuing dispatch instructions. Indeed, it cannot know this until meter data is collected long after the time that the real-time transactions are necessary.

Commission must first serve the interests of consumers.[22] The precedence of consumer interests is the foundation of the Commission's regulations[23] and is reflected in the Commission's Vision and its Mission.[24]

The Commission largely fulfills its statutory responsibility to consumers by taking steps to ensure that electricity prices are just and reasonable. The Commission is also charged with ensuring that the terms and conditions under which electric service is provided are just and reasonable, *i.e.*, consistent with the public interest. Any requirement that would place the commercial interests of utilities above the interests of consumers in obtaining reliable and uninterrupted electric service would turn the Federal Power Act on its head. Any Commission order imposing such a requirement is contrary to federal law and represents an abuse of the Commission's discretion.

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[22] *See, e.g., Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348, 355, 76 S.Ct. 368, 372, 100 L.Ed. 388 (1956) ("That the purpose of the power given the Commission by section 206(a) is the protection of the public interest, as distinguished from the private interests of the utilities, is evidenced by the recital in section 201 of the Act that the scheme of regulation imposed is 'necessary in the public interest.' "); *Maine Public Service Company v. Federal Power Commission*, 579 F.2d 659, 664 (1st Cir.1978) ("The primary purpose of this mechanism is to protect consumers from excessive rates and charges--any protection received by a utility is incidental."); *Natl. Ass'n for the Advancement of Colored People v. FPC*, 520 F.2d 432, 438 (D.C.Cir. 1975) ("Of the Commission's primary task there is no doubt, however, and that is to guard the consumer from exploitation by non-competitive electric power companies.").

[23] *See, e.g.*, 18 C.F.R. § 2.26(b) (listing factors the Commission will consider to determine if a Section 203 application "is consistent with the public interest"); 18 C.F.R. § 125.2(a)(5) (allowing the Commission to shorten the period for records retention upon a showing that "preservation of such record for a longer period is not necessary or appropriate in the public interest or for the protection of investors or consumers"). Indeed, the phrase "public interest" appears in 53 of the Commission's regulations (18 C.F.R.).

[24] Although one element of the Commission's Vision is "promoting Competitive Markets," two of the remaining four elements of the Commission's Vision are "Protecting Consumers" and "Serving and Safeguarding the Public." The Commission's Mission provides that "The Commission chooses regulatory approaches that foster competitive markets whenever possible, *assures access to reliable service at a reasonable price*, and gives full and fair consideration to environmental and community impacts in assessing the public interest of energy projects." (emphasis added).

Moreover, to do so without first adhering to the rigors of Section 206 would be arbitrary in the extreme. The issue the Commission must consider in satisfying its statutory mandate is whether the ISO Tariff strikes a reasonable balance. To isolate and change only the requirements for real-time energy transactions without first examining in full the correct allocation of payment risk is inconsistent with the public interest, especially in the context of other benefits accorded suppliers of electricity in California (*e.g.*, market-based rates), and cannot be reconciled with the Commission's statutory responsibilities.

2. The ISO Has a Legal Obligation to Maintain Reliability Within the ISO Control Area and Continuity of Electric Service to Consumers.

A requirement that the ISO obtain, in advance, a guarantee that a creditworthy counter-party will pay for all real-time dispatch orders issued to maintain the balance of supply and demand on the ISO Controlled Grid would also require the ISO to violate its Tariff, as accepted by the Commission. As the Commission has reaffirmed on numerous occasions, *including the February 14 Order*, maintenance of the reliability of its transmission system is the ISO's "primary obligation." February 14 Order, 94 FERC at 61,510. That obligation includes the obligation to operate the ISO Controlled Grid in accordance with regional reliability criteria. California law also requires the ISO to operate the ISO Controlled Grid reliably in a manner consistent with Western Systems Coordinating Council ("WSCC") criteria. Cal. Pub. Util. § 345. The Commission itself has held that operation in accordance with regional reliability criteria is required by, and satisfies, the Commission's fourth principle for independent

system operators. *Pacific Gas & Electric Co., et al.*, 81 FERC ¶ 61,122 at 61,456-57 (1997).

In addition, the ISO is the Control Area operator for the State of California. The ISO Tariff specifically adopts WSCC reliability criteria.[25] The WSCC Minimum Operating Reliability Criteria ("MORC") state explicitly, "Continuity of service to load is the *primary* objective" of the criteria. MORC at 8. The rationale behind this principle is obvious. Curtailment of firm load threatens the public health, safety, and welfare, disrupting essential services (even those exempt from such curtailment will experience collateral damage from surrounding disruptions),[26] traffic, businesses, and personal lives. The loss of traffic control can easily cause deaths and serious injury.[27] Loss of power can severely threaten livestock and crops.[28] Important research can be disrupted.[29] Most of the damage occasioned by even a temporary curtailment of electricity supply is not documented: no one records the number of ambulances delayed by loss of

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[25] For example, Section 2.3.1.1.6 of the ISO Tariff states that the ISO should be WSCC security coordinator for the ISO Controlled Grid. Section 2.1 of the Dispatch Protocol of the ISO Tariff provides that the ISO shall exercise control in compliance with all Applicable Reliability Criteria including the standards established by the North American Electric Reliability Council ("NERC") and the WSCC.

[26] *See, e.g.,* Margaret Rosenthal, *At-Risk Patients Plan Ahead for Rolling Blackouts; Power: Though Outages Are Short-lived, People Who Depend On At-Home Life Support Are Readying Backup Electrical Sources*, Los Angeles Times, March 21, 2001, (Attachment E to this filing) at B1.

[27] *See, e.g.,* Greg Risling, *Traffic Light Outages Causing Accidents, Headaches*, Associated Press, March 21, 2001 (Attachment F to this filing). Tony Saavedra, Anne Mulkern, and John Howard, *Blackouts Hit Home; At Least Four Traffic Accidents Occurred in O.C. During the Blackouts; Nevada Power Plant was Last Straw*, Orange County Register, March 20, 2001 (Attachment G to this filing). Mary Curtius and Maria L. La Ganga, *Blackout Hurls San Francisco into Chaos; Power Outage at a PG&E Substation Cripples Southern Communities*, The Fresno Bee, December 9, 1998 (Attachment H to this filing).

[28] *See, e.g.,* Brian Melley, *Fuel Costs May Lead to Rising Milk Prices*, Associated Press, December 24, 2000 (Attachment I to this filing).

[29] *See, e.g.,* Transcript: Elaine Korry, *Businesses in California Demanding that Power Suppliers Warn Them When They Will Be Hit with a Blackout*, NPR Morning Edition, March 30, 2001 (Attachment J to this filing).

traffic signals or of persons injured by the abrupt interruption of construction equipment, elevators, and the like, or the impact on the other innumerable activities that are dependent on electrical service.

The principle that continuity of service to load is paramount is incorporated in other applicable reliability requirements. The NERC Operating Manual states in Policy 5 on Insufficient Generating Capacity that "[a] control area anticipating an operating capacity emergency shall bring on all available generation, postpone equipment maintenance, schedule interchange purchases well in advance, and prepare to reduce load." Under a heading called "Requirements," the control area is to use generation and transmission facilities "to the fullest extent practicable" and only if "all other steps prove inadequate" should the control area implement manual load shedding. These reliability criteria establish that a control area operator like the ISO must take every conceivable step to balance load in real time by increasing generation before blackouts are ordered.

3. The April 6 Order Would Prevent the ISO From Taking the Steps Necessary to Ensure Continuity of Electric Service to Consumers

Since the ISO commenced operations, Participating Generators have always been required under the ISO Tariff to respond to the ISO's emergency dispatch orders so that the ISO will have the tools it needs to fulfill its reliability obligations – including the obligation to provide continuity of service to load. Participating Generators have also been required under the Tariff to respond to dispatch orders issued pursuant to real-time energy bids at all times. The need to respond to such dispatch orders during System Emergencies is especially

critical. It is for this reason that the Commission approved in Amendment No. 33 to the ISO Tariff penalties for Participating Generators that do not comply with dispatch instructions during System Emergencies. All of the California Generators have executed Participating Generator Agreements under which they have committed to comply with all applicable provisions of the Tariff, including those establishing their duty to respond to such dispatch instructions.

The relevant portions of the ISO Tariff are abundantly clear on this point. Section 4.1.2 states: "The ISO shall operate the ISO Controlled Grid . . . in a manner which ensures safe and reliable operation." Section 5.1.3 states: "Each Participating Generator shall take, at the direction of the ISO, such actions affecting such Generator as the ISO determines to be necessary to maintain the reliability of the ISO Controlled Grid. Such actions shall include . . . (a) compliance with the ISO's Dispatch instructions. . . ." Section 5.6.1 states: "The ISO shall . . . have the authority to instruct a Participating Generator to bring its Generating Unit on-line . . . or increase . . . the output of the Generating Unit . . . if such an instruction is reasonably necessary to prevent an imminent or threatened System Emergency . . . ." And Section 11.2.4.2.1 states: "[T]he ISO may, at its discretion, dispatch any Participating Generator . . . that has not bid into the Imbalance Energy or Ancillary Services markets . . . to prevent or relieve a System Emergency."

Those sections are straightforward and categorical; neither the ISO's authority nor the generator's duty is conditioned on the guarantee of

"creditworthy" purchasers for the energy generated. As discussed above, no other provision of the ISO Tariff establishes, or even intimates, such a condition.

The ISO recognizes that, in the normal course of events, generators providing energy in response to real-time dispatch instructions during System Emergencies have a reasonable expectation of payment for producing such energy at the rates established in the ISO Tariff. Mechanisms that provide some assurances of payment are an appropriate and necessary part of any normally functioning market. It scarcely bears repeating, however, that the California wholesale electric markets are far from normally functioning markets. Instead, as the Commission has recognized in numerous orders, those markets currently provide suppliers with the opportunity to charge unjust and unreasonable rates and have produced unprecedented prices for electricity in California.[30] Indeed, there is evidence before the Commission that suppliers with the ability to exercise market power have obtained unjust and unreasonable profits far beyond even those that the Commission has recognized to date.[31] Although the

[30] *See San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, et al.*, 93 FERC ¶ 61,121, at 61,349-50 (2000); *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, et al.*, 93 FERC ¶ 61,294, at 61,984 (2000); *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, et al.*, 94 FERC ¶ 61,245 (2001); *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, et al.*, 95 FERC ¶ 61,115.

[31] *See* reports entitled *Further Analyses of the Exercise and Cost Impacts of Market Power in California's Wholesale Energy Market* and *Empirical Evidence of Strategic Bidding in California CAISO Real Time Market*, both attached to the ISO's Comments to Staff's Recommendation on Prospective Market Monitoring and Mitigation for the California Wholesale Electric Power Market, which were filed on March 22, 2001 in Docket No. EL00-95-012.

Commission has not yet fully acted on that evidence, the Commission has recently reaffirmed the potential for the exercise of market power to result in unjust and unreasonable prices in the California wholesale electric markets.[32] In that order, the Commission found that the ability of generators to exercise market power during System Emergencies is great enough to warrant price mitigation.

As a result of this exercise of market power and the flaws in the restructured California electric markets, billions of dollars of additional and excessive electricity costs have been passed on to the Utility Distribution Companies ("UDCs"), including PG&E and Edison, ultimately forcing the former into bankruptcy and the latter into a state of great financial distress, under which it has failed to make full payment for amounts owed to suppliers of electricity in the ISO's markets or pursuant to ISO emergency dispatch orders.

It is in this environment that the April 6 Order must be considered. Were it not for the energy crisis in California, it would be a simple matter to provide assurances of payment for real-time energy transactions. In the current environment, however, the ISO lacks the ability to provide such assurances. The ISO itself is a not-for-profit entity that passes through all of its costs to the various entities that rely upon its services, including the California UDCs. The ISO has neither the authority nor the financial wherewithal to obtain guarantees of payment for all real-time energy transactions needed to satisfy the demand for electricity in California.

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[32] *See San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, et al.*, 95 FERC ¶ 61,115 (2001).

As discussed above, CDWR has agreed to cover some purchases of energy made to serve the customers of the UDCs. CDWR has not committed, however, to guarantee payment for all real-time transactions in the ISO's imbalance energy market. The ISO has no ability or authority to force DWR or any other entity to provide such guarantees.

Moreover, the Commission cannot rely upon the action of a non-jurisdictional entity such as CDWR to ensure that one of the Commission's directives does not result in harm to the very consumers the Commission is charged to protect. The Commission does not have the authority to direct CDWR to provide credit assurances. The Commission has not addressed its orders to any public utility within its jurisdiction that is capable of providing credit support for the substantial costs of real-time energy transactions under the market-based rates that the Commission continues to authorize in California. Rather, the only "creditworthy entity" identified in the February 14 and April 6 Orders is one not subject to the Commission's jurisdiction, CDWR. Given the inability of the ISO or any other public utility to guarantee payment for all real-time emergency dispatch instructions, the ISO is left without any assurance that it can satisfy its primary obligation of maintaining the balance of supply and demand on the ISO Controlled Grid. Indeed, one Commissioner concedes that the April 6 Order puts the ISO between a rock and a hard place:

> My concern in this case is that a strict application of the ISO's existing creditworthiness standards may prevent the California ISO from performing its fundamental task of keeping the system in balance and thereby maintaining the reliability of the grid. If the ISO is unable to purchase power for the unscheduled load of the largest utilities in California, I worry that the ISO may not be able to

> do its job. I am voting for today's order, but am troubled by the seemingly irreconcilable conflict between assuring sellers that they will be paid and precluding the ISO from accomplishing its fundamental mission.

April 6 Order, Massey conc., 95 FERC at 61,081.[33]

The risk identified by Commissioner Massey is even greater than the Commission could have known when the April 6 Order was issued. On that same date, the ISO filed with the Commission a report that provides a detailed analysis of historical and forecasted near-term peak electricity supply and demand levels for the ISO Control Area.[34] This report concludes that the ISO Control Area is likely to experience significant supply deficiencies during summer 2001, forecasting a peak demand resource deficiency ranging from 600MW to nearly 3,700 MW. As this filing is being finalized, the Control Area is under a Stage 2 System Emergency and the ISO anticipates calling for firm load curtailment by the end of the day.

Given the current conditions, application of the April 6 Order with respect to real-time energy transactions makes continuity of electric service to citizens in California and the reliability of the ISO Controlled Grid subservient to the desire of generators to obtain additional guarantees of payment for the electricity they provide. It creates a very real risk that the ISO will have to cut service to

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[33] In an Order issued in *California Independent System Operator Corp. v. Reliant Energy Services, Inc. et al.,* No. Civ. S-01-238 FCD/JFM on April 9, 2001, Judge Damrell of the United States District Court, Eastern District of California echoed the concerns raised by Commissioner Massey. As noted above, this order is provided as Attachment D to this filing.

[34] This report, the *CAISO 2001 Summer Assessment*, was attached to the ISO's April 6 filing of its proposed Market Stabilization Plan in Docket No. EL00-95-12.

consumers in California, with the requisite risks to public health and safety not because energy is unavailable, but because the ISO cannot guarantee payment to suppliers. Such a result cannot be reconciled with the Commission's statutory duty to consumers and therefore represents an abuse of the Commission's discretion in implementing the Federal Power Act.

4. There Is No Requirement For the Commission to Guarantee Payment to All Suppliers of Electricity.

The Commission's April 6 Order suggests that suppliers of electricity are entitled to a Commission-enforced guarantee of payment for all energy transactions. This has never been the case. Even under a cost-of-service rate scheme, the Commission never provided energy suppliers with an absolute guarantee that they would be fully reimbursed for their services. Instead, the Commission simply provided suppliers the *opportunity* to recover their costs and a reasonable rate of return.[35] If a supplier was not paid, it could pursue its remedies in the appropriate forum, generally the applicable state court.[36] Under the current market-based rate regime in California, suppliers have much greater opportunities to earn profits above their costs. Paradoxically, however, the April 6 Order suggests that suppliers with market-based rates should receive payment assurances that were never available to suppliers under a cost-based regime. There is no justification for doing so.

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[35] *See, e.g.*, *Jupiter Energy Corporation*, 41 FERC ¶ 63,008, at 65,019 (1987) ("[B]asic to ratemaking principles is the doctrine that the Commission is not required to guarantee cost recovery; rather it must provide a reasonable opportunity . . . to recover costs prudently incurred").

[36] *See Arkansas Louisiana Gas Company v. Hall*, 453 U.S. 571 (1981).

Any potential economic consequences to the California Generators of their not being guaranteed payment for every real-time transaction must be placed in the proper context. Even after the filing by PG&E for Chapter 11 bankruptcy protection, there is no evidence that suppliers of energy in California will ultimately be deprived of just and reasonable compensation for energy they have provided to serve customers in California. In addition to the fact that PG&E publicly has stated its intention to pay all debts in full,[37] CDWR will be standing behind the bulk of the ISO's real-time energy transactions. CDWR has only refused thus far to provide support for unreasonable bids submitted by energy suppliers. The ISO notes that, were CDWR to commit categorically to back all real-time energy transactions during System Emergencies, regardless of price, CDWR would be exposed to the suppliers' ability to exercise market power and obtain unjust and unreasonable prices. In fact, if the suppliers were willing to submit bids within the range determined by CDWR to be reasonable, which arguably compensates su0ppliers for their costs and then some, then the suppliers would be guaranteed credit support for real-time emergency dispatch orders. It is only the continued insistence of suppliers to submit bids at outrageous prices that places them at risk of having no credit support for their real-time transactions.

On a going-forward basis, to the extent that PG&E incurs future power purchase expenses on its own behalf, the bankruptcy filing should provide

[37] *See, e.g.,* Energy Daily, April 9, 2001 (Attachment K to this filing).

suppliers with additional avenues for recovery.[38] Moreover, California State authorities and this Commission are working tirelessly to provide market conditions under which the UDCs will be able to pay their debts. The California Public Utility Commission has approved two sets of rate increases, totaling over 40%, and created financial incentives for demand reduction.[39] Many of the suppliers of electricity in California have already entered into bilateral transactions with CDWR, and this opportunity would still be available to them even if there were not a creditworthy counter-party to every real-time energy transaction during a System Emergency. Thus, the risk of loss to the California Generators for complying with such dispatch instructions is minimal.[40]

At the same time, the suppliers of electricity have already reaped astounding profits from their participation in the California wholesale electric markets,[41] profits that certainly cushion the California Generators against any

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[38] Under the Bankruptcy Code, obligations incurred by a debtor-in-possession for goods delivered and services provided following the filing of its bankruptcy petition are entitled to priority in payment as administrative claims. Debtors-in-possession are required to pay administrative claims in full as a condition of reorganizing under Chapter 11. PG&E has represented to both its Bankruptcy Court and the public that it intends to pay its administrative claims timely and in full, and that it has the funds available to do so.

[39] Interim Opinion, Application of Southern California Edison Company for Authority to Institute Rate Stabilization Plan with a Rate Increase and End of the Rate Freeze Tariff, et al., Application 00-11-038, et al., California Public Utilities Commission (March 27, 2001); San Francisco Chronicle, March 27, 2001 (Attachment L to this filing).

[40] Indeed, it is undoubtedly the case that the suppliers assault on the ISO's credit requirements is intended to leverage CDWR into contracting at exorbitant prices. The Commission must not be a party to this ploy.

[41] AES Corporation reported a net income of $221 million for the quarter ended 12/31/00 – a 97% increase over their $112 million net income for the same quarter in 1999. Press Release, AES Corporation, AES Earns $1.46 Per Share in 2000, Up 135% Over Earlier Year (January 29, 2001). In the first quarter of 2001, AES Corporation reported revenues of $2.5 billion, a 50% increase over the first quarter of 2000. Press Release, AES Corporation, AES Reports Earnings of $.042 Per Share for the Quarter, from Recurring Operations (April 26, 2001).
Reliant Energy reported adjusted earnings of $838 million for 2000, compared to $508 million for 1999. Reliant Energy's wholesale energy group specifically made $482 million in 2000, compared to $27 million in 1999. Press Release, Reliant Energy, Reliant Energy's Wholesale Energy Businesses and Electric Operations Drove Earnings Up 65% for the Year 2000 (January

failure ultimately to realize every penny on their emergency sales during this unprecedented crisis.

The equities in this matter are clear – the tremendous risks to both the safety of the public in California which would result from limiting the ISO's ability to issue real-time dispatch instructions during System Emergencies far outweigh the economic interests of suppliers of electricity in obtaining additional guarantees that they will be paid for complying with those instructions. The Commission's conclusion in the April 6 Order is unsupported, arbitrary and capricious.

26, 2001). Reliant reported adjusted earnings of $274 million for the first quarter of 2001, compared to $134 for the first quarter of 2000. Reliant Energy's wholesale energy group specifically reported an operating income of $216 million for the first quarter of 2001, compared to an operating loss of $22 million in the first quarter of 2000. Press Release, Reliant Energy, Reliant Energy Reports Strong First-Quarter Earnings (April 16, 2001).

Williams reported income from continuing operations of $873.2 million for 2000, compared to $178 for 1999. Williams reported income of $259.3 million for continuing operations in the fourth quarter of 2000, compared to $66.1 million for the same period in 1999. Press Release, Williams, Williams' 2000 Results from Continuing Operations Quadruple 1999. Williams reported results from continuing operations of $378.3 million for the first quarter of 2001, compared to 138.9 million for the same period in 2000. Specifically, Williams' Energy Marketing and Trading segment reported a first quarter profit of $484.5 million, compared to $77.8 million for the same period in 2000. Press Release, Williams, Williams' 1st Quarter Results From Continuing Operations More Than Double Last Year (April 26, 2001).

Dynegy Inc. reported a 2000 recurring net income of $452 million, a 210% increase over their reported 1999 income of $146 million. Specifically, Dynegy Marketing and Trade reported $355 million in recurring net income -- a 252% increase over 1999's income of $101 million -- which represented 80% of the company's overall results. Press Release, Dynegy Inc., Dynegy Triples Recurring Net Income in 2000 (January 23, 2001). Dynegy Inc. reported a recurring net income of $137.5 million, a 73% increase over their first quarter 2000 income of $79.4 million. Dynegy Marketing and Trade reported $100.3 million in recurring net income – a 99% increase over the first quarter of 2000's income of $50.3 million – which represented 73% of Dynegy Inc.'s recurring net income. Press Release, Dynegy Inc., Dynegy Reports First Quarter Recurring Earnings Per Share of $0.41 (April 17, 2001).

Southern Energy Inc. reported earnings for operations for 2000 of $$366 million, a 36% increase over 1999's $270. Press Release, Southern Energy Inc., Southern Energy Inc. Reports a 36 Percent Increase In Earnings For 2000 (January 19, 2000) Mirant reported record first quarter 2001 earnings from continuing operations of $175 million, compared with $95 million for the first quarter of 2000. Press Release, Mirant, Mirant Reports 84% Increase for First Quarter 2001 Earnings (April 25, 2001). These press releases are provided in Attachment M to this filing.

V. MOTION FOR CLARIFICATION

As noted above, to the extent that neither CDWR nor any other credit-worthy entity agrees to provide financial support for all energy bids needed to satisfy demand, the April 6 Order apparently precludes acceptance of those bids. Moreover, If the ISO is required to leave such bids "standing" because of the lack of a creditworthy counter-party, the ISO would potentially be unable to issue emergency dispatch orders to balance supply with real-time demand, since that authority arguably depends upon bids being “unavailable.” If the ISO is unable either to accept real-time energy bids or to issue emergency dispatch orders to satisfy demand for electricity in real-time, the April 6 Order would require the ISO to black out customers in California notwithstanding the availability of sufficient resources to avoid those outages.

The ISO recognizes that, for the period beginning on May 29, 2001, all Generators in California will be required to offer all available capacity to the ISO in real-time. *See San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange*, *et al.*, 95 FERC ¶ 61,115 (2001). Even in the event that this requirement largely takes the place of emergency dispatch orders, it will not eliminate the essential dilemma created by the April 6 Order. If the ISO is unable to obtain a credit-worthy backer for real-time energy transactions, whether those transactions are based on mandatory real-time energy bids or emergency dispatch orders, the ISO will still be forced to institute

blackouts even though there is energy available to serve California electric consumers. During the approaching summer, such blackouts could affect millions of citizens in California who rely on the uninterrupted supply of electricity for their livelihood and well-being.

If the Commission intended for the ISO to take steps short of cutting service to consumers in the event it cannot obtain credit backing, the ISO requests clarification of what steps the Commission believes the ISO can or should take in this circumstance. To the extent that the Commission does not grant such clarification, the ISO moves that the Commission explicitly confirm that the ISO is compelled to institute blackouts under such circumstances.

VI. MOTION FOR EXPEDITED CONSIDERATION

For all the foregoing reasons, it is imperative that the Commission grant rehearing and find that the ISO is not subject to a requirement to obtain a guarantee in advance that a creditworthy counter-party will pay for real-time dispatch orders issued to maintain the balance of supply and demand on the ISO Controlled Grid during System Emergencies. At a minimum, the Commission must grant rehearing to confirm that such a requirement cannot be imposed unless or until the requirements of Section 206 of the FPA have been satisfied. Because of the potential impact of the April 6 Order on the ISO's core responsibilities and because issues related to the April 6 Order are pending in the PG&E bankruptcy proceeding, the Commission must grant rehearing of its April 6 Order as soon as possible. The ISO therefore moves that the Commission act on this filing on an expedited basis.

VII. CONCLUSION

For the reasons set forth above, the ISO urges the Commission to grant rehearing of its April 6 Order consistent with the discussion above. The ISO also moves that the Commission act on this motion in an expedited manner.

Respectfully submitted,

Charles F. Robinson	Edward Berlin
General Counsel	J. Phillip Jordan
Roger E. Smith	Michael E. Ward
Senior Regulatory Counsel	Sean A. Atkins
The California Independent System	Swidler Berlin Shereff Friedman, LLP
Operator Corporation	3000 K Street, N.W., Suite 300
151 Blue Ravine Road	Washington, D.C. 20007
Folsom, CA 95630	Tel: (202) 424-7500
Tel: (916) 608-7135	Fax: (202) 424-7643
Fax: (916) 608-7296	

Dated: May 7, 2001

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all parties on the official service list compiled by the Secretary in the above-captioned proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Washington, DC this 7th day of May, 2001.

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Sean A. Atkins