UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Calpine Corporation, Citigroup Energy Inc., Dynegy Power Marketing Inc., J.P. Morgan Ventures Energy Corporation, BE CA, LLC, Mirant Energy Trading, LLC, NRG Energy, Inc., Powerex Corporation, and RRI Energy, Inc. v. California Independent System Operator Corporation	Docket No. EL09-62-000

REPLY COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

The California Independent System Operator Corporation ("ISO" or "CAISO") hereby files its reply comments in response to the comments submitted in this proceeding regarding the Settlement Agreement filed on October 1, 2010.[1]

This Settlement Agreement resolves a complaint concerning the terms and conditions under which the ISO will allocate financial losses associated with defaults in its markets ("default losses"). The Settlement Agreement was negotiated over nearly a year through extensive discussions with a wide range of parties with an interest in the ISO wholesale electricity markets. Many of these parties agreed to be designated as Settling Parties,[2] and many other parties –

[1] The ISO submits these reply comments pursuant to 18 C.F.R. Section 385.602(f). Capitalized terms not otherwise defined herein are used in the sense given in the Settlement Agreement or, to the extent not defined in the Settlement Agreement, in the Master Definitions Supplement, Appendix A to the ISO tariff.

[2] As stated in footnote 1 of the Settlement Agreement, the Settling Parties are defined as the ISO; Calpine Corporation; Citigroup Energy Inc.; Dynegy Power Marketing Inc.; J.P. Morgan Ventures Energy Corporation; BE CA, LLC; NRG Energy, Inc.; Powerex Corporation; RRI

listed in the Settlement Agreement as Settlement Discussion Participants – authorized the ISO to state that they either support or do not oppose the settlement.[3] All of the parties filing the complaint that initiated this proceeding are Settling Parties or (in one instance) agreed not to oppose the Settlement Agreement.

The Settlement Agreement is not contested by any party. One intervenor in this proceeding, DC Energy, LLC ("DC Energy"), filed comments stating that it declined to become a Settling Party based on concerns about the impact of the settlement default loss allocation methodology on market participants that engage primarily in the sale and purchase of Congestion Revenue Rights ("CRRs") but do not participate in other ISO-related market activities.[4] DC Energy explains that it agreed not to contest the settlement based on certain commitments the ISO made to address DC Energy's concerns.

As explained below, the ISO strongly believes that the default allocation methodology implemented by the Settlement Agreement is fair and reasonable and in the public interest. Moreover, the potential allocation of default losses to CRR-only market participants under the new methodology is consistent with the Commission's recognition that there are unique risks associated with CRRs and similar financial instruments.

Energy, Inc.; Pacific Gas and Electric Company; San Diego Gas & Electric Company; Southern California Edison Company; and Morgan Stanley Capital Group Inc.

[3] As stated in footnote 2 of the Settlement Agreement, the Settlement Discussion Participants are defined as the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California; the City of Santa Clara, doing business as Silicon Valley Power; the M-S-R Public Power Agency; The Metropolitan Water District of Southern California; the Modesto Irrigation District; Mirant Energy Trading, LLC; the Northern California Power Agency; the Transmission Agency of Northern California; the California Department of Water Resources State Water Project; Golden State Water Company; and Commission Trial Staff.

The ISO and DC Energy engaged in several discussions to address DC Energy's concerns and the ISO did make certain commitments. Specifically, the ISO does commit to monitor the impact of the new default loss allocation methodology on *all* market participants, including CRR-only market participants, and to convene a stakeholder process – even prior to the deadline set forth in the Settlement Agreement if necessary – in the event the ISO determines that the new methodology should be modified. Further, the ISO does commit to exercise its authority under provisions of the Settlement Agreement to provide DC Energy and other CRR-only market participants as well as all other market participants with the information they will need to monitor the impact of the settlement. DC Energy's proposal for quarterly public reports to the Commission on the settlement methodology, however, is not something that the ISO committed to and is inconsistent with specific provisions of the Settlement Agreement.

The ISO believes that the ISO's commitments, which are consistent with the terms of the Settlement Agreement, fully address the concerns raised by DC Energy. The ISO is also authorized to state that Commission Trial Staff supports these commitments.

For these reasons, the Settlement Judge should certify the Settlement Agreement to the Commission as an uncontested settlement. The Commission should find that the uncontested Settlement Agreement is fair and reasonable and in the public interest, and should accept the Settlement Agreement, as submitted by the ISO on behalf of the Settling Parties.

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[4] DC Energy comments at 2-4.

I. Reply Comments

A. The Settlement Agreement Should Be Certified to the Commission As an Uncontested Settlement.

Only Commission Trial Staff and DC Energy filed comments on the Settlement Agreement, and neither of those participants contested the Settlement Agreement. Commission Trial Staff requests that the Settlement Judge certify the Settlement Agreement to the Commission and that the Commission "determine that the Settlement Agreement is just and reasonable and approve it without modification or condition."[5] DC Energy emphasizes that, "[t]o be clear, DC Energy does NOT request that the Settlement Judge deem the settlement to be contested based on [DC Energy's] comments."[6] Instead DC Energy asks the Commission to observe the conditions that DC Energy proposes as a basis for not contesting the settlement.

The Settlement Judge should certify the Settlement Agreement to the Commission as uncontested. In other cases in which a participant has stated that it does not contest an offer of settlement but has requested that the Commission impose conditions on the offer of settlement, the Presiding Judge or Settlement Judge has certified the offer as settlement as uncontested, and the Commission has approved the offer of settlement on that basis.[7] The Commission should do the same in the instant proceeding. [8]

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[5] Commission Trial Staff comments at 15.

[6] DC Energy comments at 6 (emphasis in original).

[7] *See, e.g.*, *Duquesne Light Co.*, 121 FERC ¶ 63,009, at PP 37, 42, 47 (2007) ("FirstEnergy requests the Commission to condition acceptance of the settlement on a reexamination of the formula rate and incentive rates contained in the settlement when Duquesne files to seek Commission permission to withdraw from PJM . . . As FirstEnergy expressly states that it does not contest the settlement, its stated concern is not a bar to certification of the settlement. . . . Overall, and on balance, this Settlement is an uncontested offer of settlement.");

B. The Commission Should Find that the Settlement Agreement Is Fair, Reasonable, and in the Public Interest, and Should Accept It as Filed.

The Commission's regulations provide that "[a]n uncontested offer of settlement may be approved by the Commission upon a finding that the settlement appears to be fair and reasonable and in the public interest."[9] For the reasons explained in the October 1 filing of the Settlement Agreement and these reply comments, the Settlement Agreement is fair and reasonable and in the public interest. As a result, the Commission should accept the uncontested Settlement Agreement without modification.

1. The Settlement Agreement Allocates Default Losses in a Fair and Reasonable Manner.

DC Energy states that, according to its own analysis, the default risk for a CRR-only market participant rises significantly under the settlement allocation methodology as compared with the net creditor allocation methodology that the Commission found to be unjust and unreasonable in its September 23, 2009

Duquesne Light Co., 123 FERC ¶ 61,139 (2008) (order approving uncontested settlement); *Pacific Gas and Electric Co.*, 108 FERC ¶ 63,006, at PP 21, 24 (2004) ("Although SWP has requested that the Commission condition acceptance of the Settlement by indicating that SWP does not accede to the definition of TRR, SWP does not specifically oppose the Settlement. . . . In light of the foregoing, the undersigned certifies the Settlement Agreement and recommends it to the Commission for approval as an uncontested settlement pursuant to Rule 602(g)."); *Pacific Gas and Electric Co.*, 108 FERC ¶ 61,290 (2004) (order approving uncontested settlement).

[8] Even if the Settlement Judge or the Commission were initially inclined to construe DC Energy's comments as implicitly contesting the Settlement Agreement, they should not, on full reflection, do so, since these comments do not satisfy the requirements of Commission regulations. The Commission's regulations require that "[a]ny comment that contests an offer of settlement by alleging a dispute as to a genuine issue of material fact must include an affidavit" supporting the allegations in the comment. 18 C.F.R. Section 385.602(f)(4). DC Energy did not include any affidavit with its comments. Therefore, the Commission should disregard DC Energy's comments to the extent they are deemed to contest the Settlement Agreement. *See, e.g.*, *Duke Energy Trading and Marketing, L.L.C.*, 125 FERC ¶ 61,345, at P 31 (2008) ("We note at the outset that NCPA failed to comply with the Commission's regulations requiring an entity opposing a settlement agreement to submit an affidavit demonstrating that there is an issue of material fact. Because NCPA did not include such an affidavit in its comments, we can only find that there is no genuine issue of material fact in this case.").

order in this proceeding.[10] DC Energy suggests that this is because "a major portion of the settlement default allocation calculation assumes that a MWh of CRR is equivalent to a MWh of Energy in terms of economic activity."[11] DC Energy claims that, under one measure, the "economic value of a CRR MWh is less than 1 percent of the economic value of an energy MWh."[12]

Under Section 11.29.17.2.1(c) of the ISO tariff as modified by the Settlement Agreement, fifty percent of each market participant's exposure to a payment default amount will be allocated in proportion to the single largest amount within one of five listed categories, calculated in MWh. The listed category that seems to concern DC Energy is "[t]he greater of (A) the quantity of CRRs acquired in CRR Auctions or transferred through the Secondary Registration System (excluding CRRs acquired in CRR Allocations) or (B) Inter-SC Trades of Energy."[13]

This tariff provision, and the balance of the Revised Default Allocation Tariff Provisions, fall within the zone of reasonableness and achieve a just and reasonable result.[14] In the September 2009 Order, the Commission stated that "it would be equitable for a default loss allocation rule to apply to all market participants," not just to ISO creditors as under the allocation methodology that

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9 18 C.F.R. Section 385.602(g)(3).

10 DC Energy comments at 3. Hereinafter, the Commission's September 23, 2009 order, *California Independent System Operator Corp.*, 128 FERC ¶ 61,271 (2009), will be referred to as the "September 2009 Order."

11 DC Energy comments at 3.

12 *Id.*

13 Settlement Agreement, Attachment 1, at Section 11.29.17.2.1(c)(5).

14 As the Commission noted in the September 2009 Order, court and Commission precedent establish that there is not a single just and reasonable rate. September 2009 Order at P 41 (citing *Montana-Dakota Utilities. Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 251 (1951)). Instead, the Commission evaluates tariff provisions to determine whether they fall into a

the Commission found to be unjust and unreasonable.[15] The Commission also found that "the connection between the benefits a member experiences and the level of costs shared is a logical one."[16]

The Revised Default Allocation Tariff Provisions allocate default losses to all market participants, including both ISO creditors and ISO debtors.[17] Under Section 11.29.17.2.1(c), fifty percent of the allocation of a payment default amount is based on five alternative metrics of an entity's participation in ISO markets as measured in MWh. This proposed methodology is the product of extensive consideration and negotiation by a broad spectrum of market participants (investor-owned utilities, generating companies, power marketers, municipalities, and others). Based on the ISO's own review of proposed settlement alternatives, the ISO concluded that the settlement methodology, including the allocation of fifty percent of a payment default amount based on five alternative MWh-based metrics, results in a reasonable allocation of default loss exposure.

The ISO also believes that the settlement methodology results in a logical connection between the level of costs shared and the benefits each market participant experiences, as well as the risks created by various categories of market products. The ISO does not believe that the allocation of default losses should be positively correlated to the auction or market value of various market

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zone of reasonableness. September 2009 Order at P 41 (citing *New York Independent System Operator, Inc.*, 124 FERC ¶ 61,238, at P 35 (2008)).

[15] September 2009 Order at PP 41-42.

[16] *Id.* at P 46.

[17] Contrary to the suggestion of DC Energy, there is nothing in the September 2009 Order which suggests that the replacement default loss allocation methodology must result in a decreased default loss exposure for any particular category of market participants.

products. To the extent the settlement methodology has the potential to allocate a greater percentage of default losses to CRR-only market participants compared to the ISO's historical approach, such an allocation would be consistent with the Commission's recognition that there are unique risks associated with CRRs. As the Commission recently noted:

> Because financial transmission rights have a longer-dated obligation to perform which can run from a month to a year or more, they have unique risks that distinguish them from other wholesale electric markets, and the value of a financial transmission right depends on unforeseeable events, including unplanned outages and unanticipated weather conditions. Moreover, financial transmission rights are relatively illiquid, adding to the inherent risk in their valuation.[18]

The Commission's statements are consistent with the ISO's own understanding of the types of risks associated with CRRs.

2. The ISO Has Made a Number of Commitments Consistent With the Settlement Agreement That Will Address DC Energy's Concerns.

Notwithstanding the ISO's conclusion that the settlement should result in a reasonable allocation of default loss exposure to all market participants, the ISO will take appropriate steps, once the settlement is implemented, to monitor the default loss allocation percentages assigned to groups of market participants and to initiate a stakeholder process in the event the ISO concludes that the Revised Default Allocation Tariff Provisions do not result in a just and reasonable default loss allocation. DC Energy explains in its comments that it decided not to contest the Settlement Agreement "primarily because the CAISO will monitor the impact of the new settlement methodology on all market participants, including CRR-

only holders, and will convene a stakeholder process before the deadline specified in the Settlement Agreement if the CAISO determines that the new methodology has become unjust, unreasonable, or unduly discriminatory."[19] The ISO will indeed take the actions that DC Energy states are the primary reasons it does not contest the Settlement Agreement.

Pursuant to the Settlement Agreement, the ISO will calculate aggregate quarterly default loss allocation percentages by groupings of market participants determined by the ISO, and will provide those percentages to each party to this proceeding as of October 1, 2010 that has executed a non-disclosure certificate.[20] The preparation and circulation of this aggregate information will allow the ISO, Commission Trial Staff, and all parties in this proceeding to monitor the impact of the new allocation methodology on various categories of market participants. Although the Settlement Agreement does not require these groupings to include a grouping of CRR-only market participants, the ISO has committed to DC Energy to establish a grouping of CRR-only market participants that will allow DC Energy and all other entities receiving the Aggregate Information to monitor the impact of the settlement methodology on CRR-only market participants collectively. In addition, under the settlement tariff provisions, the ISO will provide to the Default-Invoiced SCID for each market participant at the start of each calendar quarter that market participant's own percentage share

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[18] *Credit Reforms in Organized Wholesale Electric Markets*, 133 FERC ¶ 61,060, at P 70 (2010) (citations omitted).

[19] DC Energy comments at 4.

[20] Settlement Agreement, Section 2.5.1. Each of these groupings of market participants will consist of at least three members and will at a minimum include the following categories: investor-owned utilities, municipalities, suppliers, and marketers/importers. Settlement Agreement, Section 2.5.1.1.

of any payment default amount that may be allocated in the calendar quarter to which the percentage share applies.[21]

Also, the Settlement Agreement requires the ISO to begin a stakeholder process, no later than six months prior to the fifth anniversary of the date the Commission issues an order accepting the Settlement Agreement, to determine whether there is a need to revise or replace the Revised Default Allocation Tariff Provisions.[22] The ISO commits to begin this stakeholder process earlier than that minimum six-month point if the data collected by the ISO over time indicates that the new settlement methodology is having an unjust or unreasonable impact on any group of market participants, including but not limited to CRR-only market participants.

DC Energy requests that the Commission require the ISO to "publicly disclose analysis on the impact of the Settlement Agreement on all stakeholder groups" and to "produce such analysis periodically, for instance through quarterly reports to the Commission starting with the implementation of the new default allocation mechanism."[23] This is not something the ISO committed to do and would be contrary to the express provisions of the Settlement Agreement.

Under the Settlement Agreement, each party in this proceeding as of October 1, 2010 that executes a non-disclosure certificate will be entitled to receive aggregate quarterly default loss allocation percentages by the groupings

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[21] Settlement Agreement, Attachment 1, at Section 11.29.17.2.7.

[22] Settlement Agreement, Section 2.3. The Settlement Agreement goes on to state that, upon conclusion of the stakeholder process, and at least three months prior to the fifth anniversary of the issuance of a Commission order accepting the Settlement Agreement, the ISO will make a filing with the Commission pursuant to Section 205 of the Federal Power Act either to request that the effectiveness of the revised default allocation tariff provisions be continued or to file amendments to modify or replace them. *Id.*

determined by the ISO for purposes of monitoring the settlement.[24] Pursuant to other provisions of the Settlement Agreement, the only circumstances in which this aggregate information would be made publicly available are if the stakeholder credit working group established pursuant to the Settlement Agreement recommends, after stakeholder input, that the aggregate information should be publicly released, and the ISO Governing Board then approves such disclosure.[25]

If the Commission were to approve the Settlement Agreement subject to the specific public quarterly reporting condition as DC Energy requests, the ISO believes such Commission action would be a modification that materially changes the benefits and burdens negotiated under the Settlement Agreement.[26] Rather than risk the termination of a settlement agreement that is the result of extensive work by a wide range of parties, the ISO instead requests that the Commission accept the ISO's commitment to raise the issue of potential public release of aggregate information through the stakeholder credit working group, consistent with the terms of the Settlement Agreement. For the reasons explained above, while this issue is being considered by the stakeholder working group, DC Energy and other parties (entities that represent a broad cross section of the market participants affected by the allocation methodology set forth in the

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[23] DC Energy comments at 4.

[24] Settlement Agreement, Section 2.5.1.

[25] Settlement Agreement, Section 2.5.2.

[26] In the event of such a material change, the Settling Parties and the Settlement Discussion Participants must meet and confer within thirty days as to whether they can all support or not oppose a modified Settlement Agreement. If all of the Settling Parties and Settlement Discussion Participants do not agree to support or not oppose a modified Settlement Agreement within sixty days of a Commission order materially changing the Settlement Agreement, then the Settlement Agreement will terminate. Settlement Agreement, Section 4.1.

Settlement Agreement) will have access to sufficient information to monitor the impact of the settlement default allocation methodology.

Therefore, the Commission should find that the ISO's commitments set forth in these reply comments – each of which is fully consistent with the terms of the Settlement Agreement – will sufficiently address DC Energy's concerns.

3. The Commission Should Not Allow a Party That Failed to Take Advantage of Opportunities to Participate in Settlement Negotiations to Disrupt the Settlement.

DC Energy acknowledges that it chose to be a limited rather than an active participant in the settlement discussions in this proceeding.[27] Indeed, although DC Energy received settlement communications and drafts of the Settlement Agreement by e-mail, DC Energy provided no substantive comments on the settlement until the ISO contacted DC Energy to inquire about listing DC Energy as a Settling Party shortly before the settlement was filed.[28]

Insofar as the Commission views DC Energy's comments as suggesting modifications to the Settlement Agreement as a condition for acceptance of the settlement, the Commission should not countenance DC Energy's eleventh-hour suggestions. DC Energy chose not to participate in settlement discussions for almost a year, from the date of the first settlement conference on October 14, 2009, which DC Energy attended, until soon before the Settlement Agreement was filed on October 1, 2010. The ISO appreciates DC Energy's agreement not to contest the settlement based on certain commitments made by the ISO to address DC Energy's concerns. The ISO notes, however, that the details of DC

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[27] DC Energy comments at 2.

[28] *Id.* at 2-3.

Energy's comments – and in particular the specifics of the proposed quarterly reporting mechanism which is contrary to the express terms of the Settlement Agreement – were not shared with the ISO prior to DC Energy's filing.

The ISO strongly believes that the commitments it has made in these reply comments, which are consistent with the terms of the Settlement Agreement, fully address DC energy's substantive concerns. In these circumstances, it would be unreasonable for the Commission to impose any additional conditions or require modifications to the Settlement Agreement. Indeed, if the Commission were to impose conditions on the ISO or modify the Settlement Agreement, it would undermine the viability of the settlement process, providing a model for participants in future settlement proceedings to raise issues at the last minute without having discussed them with the parties that took more diligent part in the settlement discussions.

II. Conclusion

Wherefore, for the reasons stated above and in the Settlement Agreement, the Settlement Judge should certify the Settlement Agreement to the Commission as an uncontested settlement, and the Commission should accept the Settlement Agreement without modification as being fair and reasonable and in the public interest.

Respectfully submitted,

/s/ Bradley R. Miliauskas

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Dated: November 1, 2010

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all parties in the above-referenced proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. Section 385.2010).

Dated at Washington, D.C. this 1st day of November, 2010.

/s/ Bradley R. Miliauskas
Bradley R. Miliauskas