THE UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company, Complainant,	)	
v.	)	**Docket No. EL00-95-045**
Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, Respondents.	)	
Investigation of Practices of the California Independent System Operator and the California Power Exchange	)	**Docket No. EL00-98-042**

REQUEST FOR REHEARING OF THE
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

Pursuant to Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.212, the California Independent System Operator Corporation ("ISO")[1] submits this request for rehearing in the above-captioned dockets. The ISO respectfully requests that the Commission revise one aspect of its July 2, 2004 Order on Settlement, 108 FERC ¶ 61,002 ("July 2 Order"), namely, its failure to grant the ISO's request for a hold harmless provision as to the ISO, its directors, officers, employees, and consultants

[1] Capitalized terms not otherwise defined herein are used in the sense given in the Master Definitions Supplement, Appendix A to the ISO Tariff.

I. BACKGROUND

On April 27, 2004, the Williams Companies and the California Parties (collectively, the "Settling Parties") filed with the Commission an Offer of Settlement and Request for Shortened Comment Period ("Settlement Agreement"). The ISO filed its initial comments on the Settlement Agreement on May 6, 2004, expressing support for the settlement. The California Power Exchange ("PX"), in its initial comments filed on the same date, requested that the Commission, in any order approving the Settlement Agreement, state that the PX, along with its directors, officers, employees and professionals, would be held harmless for implementing the settlement, as well as specifying that neither the PX, nor such individuals, shall be responsible for recovering any funds which are subsequently required to be repaid. The PX explained that such provisions would be appropriate because the PX is a non-profit public benefit corporation, and it would not be reasonable to subject its officers and employees to individual liability for engaging in the accounting necessary to implement the settlement, and that the increase in the premiums for its insurance that would result in the absence of a hold harmless provision would have to be borne by its participants.

In an addendum to its reply comments submitted on May 17, 2004, the ISO explained that the concerns raised by the PX with respect to being held harmless apply with equal force to the ISO. Therefore, the ISO requested that the Commission state, in any order approving the settlement agreement, that the ISO, along with its directors, officers, and employees, will be held harmless with respect to the settlement and accounting activities that it will have to perform in order to implement the Settlement Agreement, and that neither the ISO, nor its directors, officers, or employees, will be

responsible for recovering any funds disbursed pursuant to the Settlement Agreement, which are subsequently required to be repaid.

On July 2, 2004, the Commission issued an order approving the Settlement Agreement. 108 FERC ¶ 61,002 (2004). Therein, the Commission addressed the ISO's and PX's requests for hold harmless language, and despite the fact that no party opposed the ISO's and PX's request, and the Settling Parties stated that they supported this request, the Commission concluded that such language was not necessary, and that the PX and ISO had not justified such a provision. The Commission pointed out that no other party in these proceedings has sought indemnification. Finally, the Commission stated that if the PX and ISO believe that any of the Commission's regulations will serve as an impediment to their complying with the directives in this order, they may file a request for waiver of those regulations.

II. SPECIFICATION OF ERROR

The ISO respectfully submits that the July 2 Order erred in the following respect:

- By failing to hold the ISO, and its directors, officers, and employees harmless with respect to the settlement and accounting activities that it will have to perform in order to implement the Settlement Agreement, and by failing to find that neither the ISO, nor its directors, officers, or employees, will be responsible for recovering any funds disbursed pursuant to the Settlement Agreement, which are subsequently required to be repaid.

III. ARGUMENT

In the July 2 Order, the Commission stated that holding the ISO and PX harmless with respect to their role in implementing the Settlement Agreement was not "necessary." July 2 Order at P 47. This finding is in error. The unique circumstances

of this proceeding make it necessary to hold harmless the market operators (*i.e.*, the ISO and PX) that are ultimately tasked with implementing this Settlement Agreement and others like it, along with their directors, officers, employees and consultants.[2] First, the financial impact of this Settlement Agreement is substantial – over $100 million dollars. Although the ISO fully supports the Settlement Agreement, several parties have protested it, which suggests that the transfer of funds, and related accounting adjustments, to be performed by the ISO and PX, will not go unchallenged. Indeed, given the contentious nature of this proceeding, further litigation on this Settlement Agreement is foreseeable, if not assured.

The flow of funds pursuant to the Settlement Agreement will also require unprecedented accounting adjustments on the part of the ISO. These accounting adjustments will not be made under the terms of the ISO Tariff, but rather pursuant to the Settlement Agreement, the terms of which have been determined by a subset of parties to this proceeding. As the Commission is well aware, the ISO Markets are not bilateral in nature. However, this settlement requires the ISO to adopt that fiction as between the Settling Parties, and make billing adjustments accordingly. A Market Participant could file a complaint or bring suit against the ISO, and/or its directors, officers, and employees, claiming that the ISO did not make appropriate accounting adjustments, and as a result did not reflect the appropriate amount of refunds or receivables owing to that participant.

[2] Although the ISO did not include "consultants" in its comments requesting the adoption of hold harmless provisions, the ISO believes that it is appropriate to hold them harmless along with directors, officers, and employees of the ISO, because of the important role they will likely play in the implementation of the provisions of the settlement at issue, along with any other settlements approved by the Commission in this proceeding.

The most troubling possibility, however, is that the flow of funds pursuant to the Settlement Agreement will create a shortfall in money available to pay creditors who elect not to participate in the Settlement Agreement. The Settlement Agreement itself recognizes this, stating that Williams agrees to underwrite any shortfall that remains after the true-up provisions in the Settlement Agreement. However, if Williams was unable to meet this obligation, for any reason (such as lack of funds due to bankruptcy), it is foreseeable that participants who claim they were short-paid would bring action against the ISO (and even its directors, officers, and employees), to recover any deficiencies that result from implementation of the Settlement Agreement.

All of these problems will be amplified as the Commission approves more settlement agreements in this proceeding. Currently, a proposed settlement between Dynegy and the California parties is pending before the Commission, and the ISO understands that a settlement between Duke and the California Parties will be filed with the Commission shortly. As the volume of settlements increases, the task of implementing those settlements will become more and more complicated. Likewise, the possibility a party will bring an action against one, or both, of the market operators also increases. For this reason, the ISO believes that it is critically important that the Commission hold the ISO (along with its directors, officers, employees, and consultants) harmless with respect to the implementation of all of the settlements reached in this proceeding that involve the flow of monies through the ISO Markets.[3]

[3] The ISO plans to shortly file supplemental comments on the proposed Dynegy settlement requesting the same type of hold harmless protection as discussed herein in reference to the Williams settlement. Again, the ISO believes that the Commission should afford the ISO this protection with respect to all settlements that impact the flow of monies through ISO Markets in this proceeding.

The need for protection from suits is particularly acute with respect to the directors, officers, and employees of the ISO. These individuals should not be subjected to litigation, along with its attendant costs and expenditure of time, for merely implementing a settlement authorized by the Commission.

There is nothing in the Settlement Agreement, or in the Commission's July 2 Order, that recommends against, or is inconsistent with, granting the ISO and the individuals associated with it the protection requested here. Indeed, as recognized by the Commission, the Settling Parties expressly supported hold harmless provisions for the ISO. This is unsurprising, given that the Settlement Agreement provides for numerous mutual releases and waivers, which will effectively "hold harmless" the Settling Parties from existing and potential claims. It is unreasonable to permit the Settling Parties to insulate themselves in this manner without providing similar protection to the entities that will be required to financially reflect and implement the Settlement Agreement. A hold harmless provision of the type requested by the PX and the ISO is also consistent with the approved terms of the ISO Tariff, which provides that the ISO shall not be liable in damages to any Market Participant for "any losses, damages, claims, liability, costs or expenses . . . arising from the performance or non-performance of its obligations" under the ISO Tariff, except to the extent that they result from negligence or intentional wrongdoing on the part of the ISO. ISO Tariff, Section 14.1. Finally, holding harmless the ISO and its associated individuals is consistent with the spirit of the Settlement Agreement, as well as the Commission's approval thereof. The Commission explained in the July 2 Order: "Approval will also avoid further costly litigation, eliminate regulatory uncertainty and bring to a close a number of disputes

stemming from the California market disruptions of 2000-2001." However, without appropriate protection for the market operators, instead of a reduction in litigation and uncertainty, the likely result will merely be a shifting of litigation and uncertainty from the ISO Market as a whole to the ISO and PX.

Another reason given by the Commission for declining to include hold harmless provisions for the ISO and PX is that "no other entity involved in these proceedings has sought indemnification." July 2 Order at P 47. As noted above, however, the Settlement Agreement itself contains provisions that effectively operate to "hold harmless" the Settling Parties from various present or potential liabilities. Moreover, it is not surprising that the ISO and PX are the only parties (outside the Settling Parties) to request hold harmless provisions applicable to them – they are the two market operators that will be required to perform all of the billing adjustments and cash distribution activities to actually implement the terms of the Settlement Agreement. Therefore, the ISO and PX are naturally the most at risk with respect to any complaints concerning the financial impacts of the Settlement Agreement.

Finally, the Commission's willingness to entertain requests for waiver of its regulations if those regulations "serve as an impediment" to the ISO and PX complying with the July 2 Order is not sufficient. July 2 Order at P 47. It is not a violation of the Commission's regulations that concerns the ISO. Instead, as discussed above, and in its May 17 reply comments requesting hold harmless language it is the possibility of third-party actions against the ISO, or even its directors, officers, employees and consultants, to recover funds paid out under the Settlement Agreement and required to be repaid, or based on the accounting actions taken by the ISO in implementing the

Settlement Agreement. Unfortunately, waiver of the Commission's regulations will do nothing to prevent such actions.

IV. CONCLUSION

For the reasons set forth above, the ISO respectfully requests that the Commission reverse its ruling in the July 2 Order denying a hold harmless provision with respect to the ISO, and adopt an appropriate hold harmless provision which holds the ISO, and its directors, officers, employees and consultants harmless with respect to the settlement and accounting activities that it will have to perform in order to implement the Settlement Agreement, and also with respect to any funds disbursed pursuant to the Settlement Agreement which are subsequently required to be repaid but, for whatever reason, cannot be recovered.

Respectfully submitted,

/s/ Michael Kunselman

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Dated: August 2, 2004

CERTIFCATE OF SERVICE

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

Dated at Folsom, CA, this 2nd day of August, 2004.

/s/ Gene L. Waas
Gene L. Waas