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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	**)** **)**	**Docket No. ER01-889-015**

RESPONSE OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO COMMENTS ON COMPLIANCE FILING

Pursuant to Rule 213 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("Commission" or "FERC"), 18 C.F.R. § 385.213, the California Independent System Operator Corporation ("ISO")[1] hereby responds to comments filed by the Indicated Generators ("Generators")[2] on the ISO's October 3, 2003 compliance filing in the above-referenced docket.

I. BACKGROUND

On November 7, 2001, the Commission issued an order in this docket in which the Commission found that the California Department of Water Resources ("DWR" or "CERS") had assumed responsibility for the purchases made in the ISO Markets, and functioned as the Scheduling Coordinator, for the net short load of Pacific Gas & Electric Company ("PG&E") and Southern California Edison Company ("SCE") (collectively, the "IOUs"). *California Independent System Operator Corp.*, 97 FERC ¶ 61,151 (2001) ("November 7 Order"). The Commission required the ISO to invoice the

[1] Capitalized terms not otherwise defined herein shall have the meanings set forth in the Master Definitions Supplement, Appendix A to the ISO Tariff.

CERS for all transactions entered into on behalf of the net short load of the IOUs during the period January 17, 2001 through July 31, 2001, within 15 days of the date of that order. The ISO submitted its compliance filing on November 21, 2001, in which the ISO informed the Commission and parties that it had invoiced CERS for the unpaid amount of ISO Market transactions made on behalf of the non-creditworthy IOUs for the period January 17 through July 31, 2001.

On March 27, 2002, the Commission issued an order in which it accepted "stated commitments by the ISO . . . to treat DWR as a Scheduling Coordinator and bill DWR directly for the non-creditworthy [IOUs'] net short position." *California Independent System Operator Corp*., 98 FERC ¶ 61,335 (2002) ("March 27 Order"). However, the Commission required that the ISO "re-invoice those gross amounts owed by DWR for all [CA]ISO transactions DWR entered into on behalf of the non-creditworthy UDCs. . . and provide a transparent means by which this Commission and other parties can determine whether the invoiced amounts were properly calculated." *Id*. In response, on April 17, the ISO submitted its compliance filing ("April 17 Compliance Filing") along with the gross invoices of PG&E and SCE, the net invoices of CDWR, and a worksheet and summary of these invoices. Additionally, shortly after the issuance of the March 27 Order, two suppliers, Reliant and Dynegy, filed motions arguing that the ISO had misapplied funds it received from CERS for the month of January 2001, and requested that the Commission require the ISO to reallocate CERS payments so that those amounts are only applied to debts that accrued in the ISO Markets for the period January 17-31, 2001.

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[2] The Indicated Generators consist of Dynegy Power Marketing, Inc. ("Dynegy"), Reliant Energy Power Generation, Inc. ("Reliant"), and Williams Power Company, Inc. ("Williams").

On November 25, 2002, the Commission issued an order in which it ruled on several issues. First, in addressing Dynegy and Reliant's motions, the Commission concluded that the ISO had misapplied CERS payments for the month of January 2001 and required the ISO to "reallocate its pro rata disbursements for the entire month of January 2001, and disburse funds from [CERS] allocated for January 2001 to those that supplied power for the period January 17-31, 2001." *California Independent System Operator Corp*., 101 FERC ¶ 61,241 (2002) ("November 25 Order"). Additionally, in ruling on the April 17 Compliance Filing, the Commission stated that the ISO had not sufficiently explained whether or not the ISO had properly calculated the amounts invoiced to CERS on behalf of the net short position of the IOUs. The Commission based this decision on a finding that the ISO had failed to provide "adequate supporting documentation that would allow for transparency" in determining whether the ISO had properly calculated the amounts invoiced to CERS. Therefore, finding that there were material issues of fact as to whether the ISO had properly calculated amounts invoiced to CERS, the Commission set for hearing issues relating to whether the ISO has properly calculated amounts owed by and owing to CERS.

On December 9, 2002 a pre-hearing conference was convened before the Presiding Judge, at which time the Parties developed a proposed procedural schedule and discussed steps to take towards the goal of reaching a negotiated settlement of the issues set for hearing with respect to the ISO's calculation of the amounts invoiced to CERS. Throughout the early months of 2003, the parties to this proceeding engaged in a series of technical conferences and workshops in an attempt to better understand and resolve this issue. During this period, the ISO also made available various data that

was requested by the participants. On February 18, 2003, the ISO filed an unopposed motion to temporarily suspend the procedural schedule to allow the parties to focus on reaching a complete settlement and preparing an offer of settlement to file with the Commission. The Chief Administrative Law Judge granted the ISO's request and, on February 25, 2003, suspended the procedural schedule until "otherwise ordered."

On October 3, 2003, the ISO filed its proposed methodology to re-allocate funds received from CERS for the month January 2001, in accordance with the November 25 Order ("October 3 Compliance Filing"). On November 14, 2003, two parties, the Generators and PG&E filed comments on the October 3 Compliance Filing.

II. DISCUSSION

A. The ISO's Compliance Filing Does Not Grant CERS Preferential Treatment for Amounts Owed

In their comments, the Generators allege that the Compliance Filing "unfairly credits CERS with a full payment for energy sales during January 2001 while other sellers are credited with only partial payment." Generators at 2. Generators state that by treating CERS as a Creditor in the amount of $220.6 million for energy provided to the ISO by CERS, the ISO has "insulated CERS from the shortfall in revenues needed to pay these energy costs." *Id*. at 3. Generators speculate that the ISO based the offsetting of CERS payments on the practice of netting accounts receivable and payable for each Scheduling Coordinator on the Scheduling Coordinator's invoice. Generators claim that in the case of CERS, however, netting is not permitted because it involves the

netting of amounts across multiple Scheduling Coordinator IDs ("BAIDs"), a practice generally prohibited by the ISO.

As an initial matter, Generators argument is out of place here. The specific question of whether the ISO properly invoiced CERS for the net short load of the IOUs was made the subject of separate hearing procedures by the Commission in the November 25 Order. In the November 25 Order, the Commission dealt with several issues. First, the Commission determined that the ISO had misapplied payments received from CERS to debts incurred prior to January 17, 2001, and required the ISO to "reallocate its pro rata disbursements for the entire month of January 2001, and disburse funds from [CERS] allocated for January 2001 to those that supplied power for the period January 17-31, 2001." November 25 Order at P. 17. Separately, the Commission addressed the question of whether the ISO has properly calculated the amounts it invoiced CERS for the January through August 2001 period. Concluding that there were still outstanding material issues of fact with respect to this issue, the Commission set for hearing the issues of:

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

Id. at P. 26.

The Commission did not include within the ambit of the Administrative Law Judge's review the issue of the reallocation of amounts to suppliers who provided energy for the

period January 17-13, 2001. However, the Commission explicitly stated that the issue of whether the ISO had properly calculated the amounts owed to and owing from CERS was an issue to be addressed in the hearing process. Generators dispute the practice of offsetting amounts owed by CERS to the ISO Market with those amounts that are owed to CERS by the ISO Market for the January 17 through July 31, 2001 period. This argument is aimed directly at the issue of whether the ISO correctly calculated the amounts owed to and owing by CERS. The October 3 Compliance Filing did not change anything with respect to the ISO's calculations of the amounts that CERS is owed by the ISO market or owes to the ISO Market for the January 17 to July 31, 2001 period. Therefore, the Commission should reject Generators argument as out of place here. If Generators wish to pursue this issue, they should be required to do so in the context of the hearing procedures established by the November 25 Order.

If the Commission believes that this issue is appropriately addressed in this proceeding, the Generators' argument should, nonetheless, be rejected for several reasons. First, the netting of the amounts owed to CERS for energy sales made to the ISO Markets against the amounts that CERS owes to the ISO Markets for purchases made on behalf of the net short load of the IOUs does not involve "netting across BAIDs" as the Generators claim. Three of the BAIDs cited by the Generators (1011, 2769, 1010) correspond to the California IOUs. However, pursuant to the Commission's requirement, as set forth in the November 7 Order, that the ISO treat CERS as the Scheduling Coordinator for the IOU's net short load, the ISO re-invoiced CERS for the amounts charged to the IOUs' BAIDs associated with the net short load. The ISO prepared separate invoices for CERS that included the charges relating to the net short

load, in order to reflect CERS as the Scheduling Coordinator for that load. In effect, the charges associated with the net short load were transferred from the IOUs' BAIDs to CERS's BAID. The Generators' argument flies in the face of the Commission's requirement that the ISO treat CERS as the Scheduling Coordinator for the net short load, because acceding to the Generators' request would result in the ISO treating the IOUs, rather than CERS, as the Scheduling Coordinator for that load. Such treatment is clearly inappropriate.

Generators' attempt to analogize the netting of CERS credits and charges to the type of "self help" by suppliers that the Commission earlier rejected is a red herring. Pursuant to the ISO Tariff, the ISO has always invoiced Scheduling Coordinators for the net of all charges and credits associated with that Scheduling Coordinator's monthly activity. This is entirely different from suppliers' attempt to offset amounts they owed the ISO Market against amounts owed to them by the ISO Markets for previous months because sufficient funds had not been available to pay all ISO Creditors. In invoicing CERS, the ISO did not net CERS charges and credits across different months, or permit CERS to withhold payment to the ISO because of outstanding amounts still due to them, but instead netted charges and credits attributable to CERS within the same month, consistent with standard ISO invoicing practices as set forth in the ISO Tariff and Protocols.

The Commission has never suggested that the ISO's proposal to net charges and credits attributable to CERS as a Scheduling Coordinator was unreasonable. The ISO first filed with the Commission its proposal to net amounts owed to CERS against amounts due from CERS in its November 21, 2001 compliance filing made in response

to the November 7 Order. In the March 27 Order addressing that compliance filing, the Commission stated that it would require documentation from the ISO substantiating the reduction of amounts due from CERS, but significantly, the Commission did not disapprove of the ISO's offsetting methodology. Likewise, in the November 25 Order, although the Commission found that the ISO had not sufficiently substantiated offsets relating to CERS, it did not suggest that the methodology of offsetting, itself, was flawed.

B. The ISO Properly Allocated CERS Funds to the Generator Fines Account

The Generators state that the ISO "appears to be using CERS revenue to allocate proceeds from generator fines when those fines already have been paid by the generators themselves." Generators at 7. The Generators claim that this is not appropriate, arguing that the Commission did not require CERS to satisfy penalties incurred by other Market Participants, and that suppliers should be made whole before the ISO's Generator Fines account is credited with additional funds. *Id*.

It is important, as a threshold matter, to understand how the ISO accounted for generator fines. Specifically, the fines that the Generators take issue with are fines levied on those generators that failed to respond to ISO dispatch instructions during system emergencies during the period covered by the refund proceeding. These fines were collected through ISO Charge Type 485 ("CT 485") and were applied to reduce the ISO's operating expenses, funded through the Grid Management Charge. *See California Independent System Operator Corporation*, 93 FERC ¶ 61,239 (2000) at 61,774. When a generator incurred CT 485 penalties, the total amount of all fines

incurred during a month was included as a charge on that generator's invoice for the month, and, like any other charge or credit, was netted against that generator's other charges and credits for that month. Because the ISO Market operates on a double entry accounting system (*i.e.*, each charge must have a corresponding credit, and vice versa), the cumulative amount of fines charged to generators for a particular month was credited to a separate Scheduling Coordinator (BAID #3126), which is treated like any other ISO Creditor. Therefore, if there are insufficient funds collected to pay all ISO Creditors during a month, the Generator Fines account is paid pro rata for that month along with all other ISO Creditors. This treatment of CT 485 penalties is consistent with the manner in which the ISO Market operates, pursuant to the ISO Tariff, in that the ISO settlements and billing system does not match distinct buyers and sellers on a transaction or ISO Charge Type basis.

In calculating the re-allocation of CERS funds for the month of January 2001, the ISO treated the Generator Fines account equally with all other ISO Creditors. The additional $10.3 million allocated to the Generator Fines account is based on the percentage of the overall balances of all ISO Creditors for the January 17-31, 2001 period attributable to the Generator Fines account. The Generators now propose that the ISO reverse this practice and give preferential treatment to one subset of ISO Creditors, namely the Generators themselves. This proposed treatment is inconsistent with both the settlement principles embodied in the ISO Tariff, as set forth above, as well as the Commission's orders in this proceeding. Nowhere in its orders in this proceeding has the Commission suggested that the ISO should accord any subset of ISO Creditors preferential treatment for payment during the period for which CERS

assumed liability for the net short load of IOUs. Indeed, such preferential treatment would be patently unfair and inconsistent with the bedrock principles of the ISO Markets. The ISO's reallocation methodology merely continues its longstanding practice, pursuant to the ISO Tariff, of treating all ISO Creditors equally. The Generators' argument should therefore be rejected.

C. The ISO Properly Allocated CERS Funds to Transmission Owners

Generators argue that the ISO inappropriately allocated CERS funds to the California IOUs acting in their capacity as Transmission Owners ("TOs"), in which they provided transmission service to ISO Market Participants during the period in which CERS was responsible for their net short load. Generators at 7. Generators contend that charges attributable to non-IOU Scheduling Coordinators, such as transmission charges, should not be "allocated to or paid by CERS." *Id*.

In September of 2002, the ISO released from escrow funds collected from CERS associated with transmission and Congestion services provided by the TOs to ISO Market Participants. Because these amounts reflected credits due to the TOs, when these funds were released from escrow they were paid pro rata to all ISO Creditors for the appropriate period, in the same manner the ISO would disburse to ISO Creditors any other funds it received. Because the TOs were ISO Creditors based on the amounts due to them for the transmission and Congestion services they provided, the TOs received their appropriate pro rata share of the funds released from escrow.

Again, the Generators, in arguing that the TOs should not be treated as ISO Creditors to the extent that they made sales of transmission and Congestion services,

advocate for a result that would favor certain ISO Creditors over other ISO Creditors, namely themselves, in the settling and invoicing of the ISO Markets. As explained above, there is no justification for granting a certain segment of ISO Creditors preferential treatment in payment under the ISO Tariff. The Commission, in its various orders in this proceeding, has not suggested that certain ISO Creditors should enjoy a preference in payment of funds received for the period in which CERS assumed financial liability for the IOU's net short loads. The Commission should therefore reject the Generators' argument and find that the ISO properly accounted for amounts relating to TO transmission and Congestion services.

D. The ISO's Proposal to Invoice the Re-Allocation of CERS Funds for January 2001 with the Refund Rerun is Reasonable

Generators state that the ISO has failed to substantiate its proposal to withhold invoicing of the results of the October 3 Compliance Filing until the ISO invoices the results of its settlements rerun in the refund proceeding. However, the ISO explained in the October 3 Compliance Filing that deferring the invoicing of the re-allocation of CERS amounts for January 2001 is sensible given the fact that the process of invoicing and collection of these amounts would need to be accounted for in the refund proceeding in any case. Moreover, this invoicing process would effectively result in the ISO attempting to collect back amounts already paid to some Market Participants that are still owed amounts from the ISO Markets for the period affected by the refund proceeding. Rather than attempting a separate invoicing and collection process, the

ISO believes that folding the re-allocation in with the refund invoicing process would be most practical.

The Generators also argue that the ISO should calculate and disburse interest on amounts relating to the recalculation of CERS payments for January, 2001. There is no need, however, for the ISO to calculate interest on these amounts, because the ISO is already required to calculate interest at the Commission rate on all unpaid amounts for the refund period, including all payments made by CERS. These interest calculations will be included in the ISO's final invoicing of transactions for the refund period.

E. The Commission Should Not Require the ISO to Provide Additional Information on the Original Distribution of CERS Funds Prior to Issuing a Decision on the October 3 Compliance Filing

Generators maintain that they have been unable to "confirm the methodology employed by the ISO in determining the initial distribution of CERS funds after payments on the November 2001 invoices were received" and request that the Commission require that the ISO work with parties to provide this information prior to accepting the October 3 Compliance Filing, or, in the alternative, set the matter for a technical conference. Generators at 9-10. As the Generators themselves acknowledge, however, the ISO has worked informally with Generators in an effort to provide them with the information requested. There is no compelling reason to defer acceptance of his Compliance Filing pending a further review of the ISO's "original" allocation of CERS payments to ISO Creditors. All that the Generators cite in support of their proposal is an unsubstantiated concern with respect to the treatment of the PX. Moreover, the ISO disbursed funds received from CERS a number of months ago. The

Generators had ample opportunity to request and review information with respect to the ISO's original allocation of CERS payments, but declined to do so. Generators' unsubstantiated concerns with respect to the original allocation of CERS amounts should not hold up a Commission decision on the October 3 Compliance Filing.

III. CONCLUSION

Wherefore, the ISO requests that the Commission reject Generator's arguments as set forth in their comments on the ISO's October 3 Compliance Filing, and accept the October 3 Compliance Filing in its entirety.

Respectfully submitted,

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CERTIFICATE 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 these proceedings.

Dated at Folsom, CA, this 1st day of December, 2003.

/s/ Gene Waas
Gene Waas

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