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FEDERAL ENERGY REGULATORY COMMISSION

The Honorable David P. Boergers
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: 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, Docket No. EL00-95-038; Investigation of Practices of the California Independent System Operator and the California Power Exchange, Docket No. EL00-98-036

Dear Secretary Boergers:

Enclosed for filing please find the original and fourteen copies of the Answer of the California Independent System Operator Corporation to Request for Clarification or, In the Alternative, Rehearing of NRG Power Marketing, Inc. and NEO California Power LLC, submitted in the above-captioned dockets.

Two additional copies of the enclosed filing are also provided to be time-stamped and returned to our messenger. Thank you for your assistance in this matter.

Respectfully submitted,

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company,	)	
	)	
Complainant,	)	
	)	
v.	)	Docket No. EL00-95-038
	)	
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. EL00-98-036

ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO REQUEST FOR CLARIFICATION OR, IN THE ALTERNATIVE, REHEARING OF NRG POWER MARKETING, INC. AND NEO CALIFORNIA POWER LLC

I. INTRODUCTION

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213, the California Independent System Operator Corporation ("ISO" or "CAISO")[1] submits this Answer to the Request for Clarification or, In the Alternative, Rehearing ("Request") of NRG Power

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

Marketing, Inc. ("NPMI") and NEO California Power LLC ("NEO California")[2] submitted in the above-referenced proceedings on June 25, 2001. NPMI and NEO California request that the Commission clarify or, alternatively, confirm on rehearing, that generators, such as NEO California, which have entered into Summer Reliability Agreements ("SRAs") with the ISO "are entitled to assurances of payment of all energy and related products they provide to or through the CAISO."[3] For the reasons described below, the Commission should find that the relief requested should be denied.

II. ANSWER[4]

A. Credit Support for the SRAs Is Unavailable

As a practical matter, the Request cannot be granted because credit support for payments required under the SRAs is not available. In a letter to Terry Winter, President and Chief Executive Officer of the ISO, dated June 8,

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[2] As explained in the Request, "NEO California is a special purpose limited liability company organized under the laws of the State of Delaware in order to provide the CAISO with capacity under the [Summer Reliability Agreements] executed on November 22, 2000." Request at 1 n.1.

[3] *Id.* at 1. NPMI and NEO California also request that the Commission direct the ISO to file revised tariff sheets to effect the above request. *Id.* at 6.

[4] Although the Commission's rules normally prohibit answers to rehearing requests, there is no prohibition on answers to motions or requests for clarification. *Compare* Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), *with* Rule 213(a)(3), 18 C.F.R. § 385.213(a)(3). Therefore, this Answer is entirely proper as a response to NPMI and NEO California's request for clarification. In addition, notwithtstanding Rules 213(a)(2) and 713(d)(1), 18 C.F.R. §§ 385.213(a)(2), 713(d)(1), the Commission has accepted answers to requests for rehearing that assist the Commission's understanding and resolution of the issues raised in a rehearing request, *South Carolina Public Service Authority*, 81 FERC ¶ 61,192 (1997); *Williams Natural Gas Co.*, 75 FERC ¶ 61,274 (1996), or clarify or shed light on those issues, *Sithe/Independence Power Partners, L.P. v. Niagara Mohawk Power Corp.*, 81 FERC ¶ 61,071 (1997); *Great Lakes Gas Transmission Limited Partnership*, 77 FERC ¶ 61,034 (1996). The ISO's proposed Answer in these proceedings will serve these purposes and will also help the Commission "to achieve a complete, accurate, and fully argued record." *Mojave Pipeline Co.*, 70 FERC ¶ 61,296 (1995), *modified*, 72 FERC ¶ 61,167 (1995), *vacated on other grounds*, 75 FERC ¶ 61,108 (1996), 78 FERC ¶ 61,163 (1997). The Answer should accordingly be accepted as a response to NPMI and NEO California's request for rehearing.

2001, the California Department of Water Resources ("CDWR") made it clear that it could not provide any such credit support. The letter states that CDWR "shall not be responsible or liable for any monetary obligations arising under any ISO Summer Reliability Agreement to which [CDWR] is not a party and which has not heretofore been superseded by a bilateral contract entered into by and between [CDWR] and [a generation] Owner."[5] Credit support is not available to the ISO from any other source. Application to the SRAs of the credit support requirements subsequently prescribed by the Commission for transactions in the markets administered by the ISO, as requested by NPMI and NEO California, would therefore preclude implementation of those agreements.

B. The Commission's May 25, 2001 Order Applies Only to Involuntary Sales Made In Compliance With the Must-Offer Requirements In Markets Administered by the ISO, Not to Bilateral Agreements In Which the Seller Was Free to Protect Itself Against Credit Risks

The ISO has advised NMPI and NEO California that, when they provide Energy to the ISO pursuant to the SRAs, the Energy sales taking place through the ISO's Imbalance Energy market will qualify for and receive credit support in accordance with the Commission's requirements. NPMI and NEO California assert in their Request that NEO California is entitled as well to an assurance of payment for capacity reservation payments under the SRAs,[6] relying on directives in the Commission's May 25, 2001 Order, 95 FERC ¶ 61,275 ("May 25 Order").

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5 This letter is included in the present filing as Attachment A.

6 Request at 4.

NPMI and NEO California are mistaken. The May 25 Order states in relevant part as follows:

> [A]s of May 29, 2001, we expect the ISO to ensure the presence of a creditworthy buyer for all transactions with all generators *who offer power in compliance with the must-offer requirement in the mitigation plan.*[7]

NPMI and NEO California ignore the italicized language quoted above, and instead baldly assert that the May 25 Order applies even in situations where generators are not providing electricity in a market administered by the ISO and are not making "transactions . . . in compliance with the must-offer requirement."

In fact, the SRAs do not fall within the scope of the Commission's creditworthy buyer requirements under the May 25 Order or other Commission Orders. The SRAs were entered into, pursuant to the ISO's Summer Reliability program, solely to provide for additional generating capacity and to ensure that the capacity will be operated during a portion of the summer peak season. They do not, however, entitle the ISO to the Energy output of that capacity or provide compensation for the supply of Energy through an ISO Market. As the ISO has explained:

> The Summer Reliability program was initiated by the ISO to meet the projected reliability needs of the ISO Controlled Grid for the coming summers. The SRAs executed by the ISO as part of the Summer Reliability program allow the ISO to dispatch the capacity that was constructed under this program up to 500 hours during super-peak periods in the summer. In return the generator was given a "capacity reservation" payment for building the unit. *The ISO is not entitled to the energy output of the unit* and therefore the energy produced by these generators may not be sold into the ISO's Imbalance Energy market and therefore may not be serving the underscheduled load that shows up in real-time. By assuring the construction of this new unit, the Summer Reliability program

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[7] May 25 Order at 61,972 (emphasis added).

> provides reliability to the entire ISO Control Area. . . . [The ISO's SRA costs] will be incurred *outside of the energy and Ancillary Services markets administered by the ISO* . . . .[8]

Thus, pursuant to the SRAs, the ISO makes payments to generators in exchange for the generators' building plants and scheduling their output for the benefit of some Load when the ISO dispatches them. The SRAs are contracts intended to create an incentive to develop new generation to increase *capacity* – moreover, they are "for capacity only."[9] The SRAs *are not* contracts to provide Energy or Ancillary Services to the markets administered by the ISO and to which the must-offer requirement applies.[10]

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[8] Memorandum from Deborah Le Vine, Director of Contracts for the ISO, and Brian Theaker, Manager of Reliability Contracts for the ISO, to ISO Board of Governors, Concerning "Summer Reliability Generation Cost Recovery" (Mar. 20, 2001), at 1-2 (emphasis added). This memorandum is available on the ISO Home Page, and is included in the present filing as Attachment B.

The ISO notes that generators that are subject to SRAs are allowed to operate outside the summer period described above. Additionally, the SRAs allow that these units could negotiate forward contracts and already be operating when the ISO would need them; such operation would satisfy the ISO's SRA dispatch rights. Consequently, the SRAs do not limit a generator to, or require a generator to rely on, payments from ISO markets.

[9] *See* Presentation by Deborah Le Vine to ISO Governing Board, Concerning "Summer Reliability Generation Program Cost Recovery" (Mar. 30, 2001), at 5 ("Summer Reliability Presentation"). As explained in the Summer Reliability Presentation, the ISO executed contracts with new generation because: (1) there is a resource deficiency in California; (2) there is a system-wide need, rather than a local problem; and (3) *capacity* is needed for peak periods. *Id.* at 6. The Summer Reliability Presentation is available on the ISO Home Page, and included in the present filing as Attachment C.

[10] The Commission's Orders on ISO credit support requirements mandate the application of those requirements only to Energy or Ancillary Services bid into the ISO's markets or provided in real time pursuant to the ISO's emergency Dispatch authority. As the Commission has explained:

> [W]e reject Petitioners' interpretation of the ISO tariff creditworthiness requirement and again conclude, as we did in the April 6 Order, that it does entitle third-party suppliers to credit protection *for both scheduled and unscheduled transactions*. The ISO's amendment would have eliminated this protection from its tariff for the two largest buyers *in its markets*.

California Independent System Operator Corporation, 95 FERC ¶ 61,391, at 62,457 (2001) (emphasis added). Nowhere in any of its "credit support" Orders does the Commission state that the ISO must provide additional credit assurances for capacity payments under long-term contracts such as the SRAs.

NPMI and NEO California appear to recognize these obstacles to the relief they request when they state that "NEO California is a special purpose limited liability company organized . . . in order to provide the CAISO with *capacity under the SRAs executed on November 22, 2000.*"[11] Additionally, NPMI and NEO California note that the SRAs are contracts "under which the CAISO will be entitled to dispatch capacity."[12] Especially given NPMI and NEO California's recognition of the purpose and function of the SRAs, their reliance on the May 25 Order in support of their position is inexplicable and misplaced. If NPMI and NEO California sell the Energy dispatched under an SRA into the ISO's Imbalance Energy market, then they will have a creditworthy buyer. They are not obligated to sell the Energy through the ISO, however, but are free to arrange bilateral transactions with buyers of their choosing. In either case, however, the ISO is not obliged to provide assurances or credit support for the capacity reservation payment that is payable under the SRAs.

C. NMPI and NEO California Would Have the Commission Alter the Bargained-For Exchange Embodied In Each of the SRAs

NPMI and NEO California argue that the directives in the May 25 Order should be deemed to apply to the SRAs to provide assurances of payment as to the SRAs.[13] However, in making this argument NPMI and NEO California ignore the fact that they freely entered into the SRAs in November 2000, six months after unprecedented high prices began to create financial strains on the buyers in the ISO's markets. Nevertheless, NPMI and NEO California did not bargain for

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11 Request at 1 n.1 (emphasis added).
12 *Id.* at 2.
13 *Id.* at 4-6.

any such assurances. Rather, they agreed to provisions of the SRAs that provide for the ISO to make payments only when paid. Article 9 of each SRA, which concerns payments, provides in relevant part as follows:

> The ISO's obligation to make any payments required under this Article 9 is expressly conditioned on the ISO's recovery under the ISO Tariff of costs it incurs under this Agreement.[14]

The above provision was among the terms to which NEO California agreed when NEO California executed the SRAs on November 22, 2000. The provision was part of the basis for all SRAs between the ISO and various parties, including NEO California. Moreover, NEO California agreed to these terms well before the May 25 Order (or any other Commission Order expanding the creditworthiness requirements of the ISO Tariff) was issued. Thus, in requesting that the directives in the May 25 Order be applied in the present case, NMPI and NEO California would have the Commission retroactively alter the bargained-for exchange that resulted in the execution of each of the SRAs.[15]

As NPMI and NEO California note, the ISO has informed NEO California that it "is not entitled to an assurance of payment for capacity transactions under

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[14] *Pro forma* SRA, Section 9.4. The *pro forma* SRA is included in the present filing as Attachment D. This language, working with various provisions of the ISO Tariff, does not prevent any SRA holder from receiving payment, but instead delays that payment until the ISO has collected the payment moneys from the market.

The ISO Governing Board approved the method for recovering costs incurred under the SRAs on March 30, 2001. The Governing Board resolution approving the method is available on the ISO Home Page, and is included in the present filing as Attachment E. As explained in the resolution, the ISO recovers costs incurred under SRAs as provided in Section 2.3.5.1.8 of the ISO Tariff, i.e., costs associated with each hour of the Summer Period (June 1 – October 31) "shall be charged to each Scheduling Coordinator pro rata based upon the same proportion as the Scheduling Coordinator's metered hourly Demand (including exports) bears to the total metered hourly Demand (including exports) served in that hour."

[15] The ISO also notes that the Commission has accepted the SRAs in question for filing pursuant to the Section 205 of the Federal Power Act. *See* Filing by NEO California Power LLC, Docket No. ER01-1558-000 (Mar. 15, 2001); Letter Order Addressed to NEO California Power LLC, Docket No. ER01-1558-000 (Apr. 27, 2001). Modification of these SRAs, without mutual

the SRAs."[16] This ISO action is consistent with its policy of making developers aware "that the ISO's ability to make the SRA payments depends on the ISO's ability to collect those moneys from the market."[17] It is also consistent with the express terms of the May 25 Order, quoted above, and with the circumstances prevailing when the SRAs were executed.

III. CONCLUSION

For the foregoing reasons, the ISO respectfully requests that the Commission deny the request for relief filed by NPMI and NEO California.

Respectfully submitted,

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agreement of the parties to these SRAs, would require the initiation of a complaint proceeding under Section 206 of the Federal Power Act.

[16] Request at 4.

[17] *See* Memorandum from Donald L. Fuller, Director of Client Relations for the ISO, to the ISO Board of Governors, Concerning "Summer 2001 Preparedness Update and Demand Response Programs" (Mar. 7, 2001), at 5. This memorandum is available on the ISO Home Page, and is included in the present filing as Attachment F. *See also* Memorandum from Donald L. Fuller to the ISO Board of Governors, Concerning "Summer 2001 Preparedness Update" (June 21, 2001), at 3. This memorandum is available on the ISO Home Page, and is included in the present filing as Attachment G.