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March 22, 2005

Via Electronic Filing

The Honorable Magalie R. Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: California Independent System Operator Corporation
Docket Nos. ER03-683-007

Dear Secretary Salas:

Enclosed please find the Motion for Leave to File Answer and Answer of the California Independent System Operator Corporation to Protests, submitted in the captioned docket.

Feel free to contact the undersigned with any questions. Thank you for your attention to this matter.

Respectfully submitted,

/s/ Bradley R. Miliauskas
Kenneth G. Jaffe
Bradley R. Miliauskas

Counsel for the California
Independent System Operator
Corporation

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	))	**Docket No. ER03-683-007**

MOTION FOR LEAVE TO FILE ANSWER AND ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO PROTESTS

On February 14, 2005, the California Independent System Operator Corporation ("ISO")[1] submitted a compliance filing ("February 14, 2005 Compliance Filing") in the above-captioned proceeding. The ISO submitted that filing to comply with the January 6, 2005 Order issued in the proceeding, 110 FERC ¶ 61,007 ("January 6, 2005 Order"). On March 7, 2005, Coral Power, L.L.C., Energia Azteca X, S. de R.L. de C.V., and Energia de Baja California, S. de R.L. de C.V. (collectively, "Coral Power") and Termoeléctrica de Mexicali de R.L. de C.V. ("TDM") submitted protests of the February 14, 2005 Compliance Filing. Pursuant to Rules 212 and 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.212, 385.213, the ISO hereby respectfully requests leave to file an answer, and files its answer, to Coral Power's and TDM's protests.[2] As explained below, the Commission should reject the

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

[2] The ISO requests waiver of Rule 213(a)(2) (18 C.F.R. § 385.213(a)(2)) to permit it to make an answer to the protests. Good cause for this waiver exists here because the answer will aid the Commission in understanding the issues in the proceeding, provide additional information to assist the Commission in the decision-making process, and help to ensure a complete and accurate record in this case. *See, e.g.*, *Entergy Services, Inc.*, 101 FERC ¶ 61,289, at 62,163

arguments presented by Coral Power and TDM. These arguments either reflect a misunderstanding of the ISO's compliance filing or seek to import elements into the decremental reference price methodology that were not contemplated by the Commission in its January 6, 2005 Order, which would dramatically change the Commission-approved methodology and which are otherwise unjustifiable.

I. ANSWER[3]

A. The Numerous Additional Costs Proposed by Coral Power and TDM Should Not Be Included in the Recovery of Start-Up Costs.

Coral Power argues that the ISO's proposed tariff changes for the recovery of Start-Up Costs, contained in the February 14, 2005 Compliance Filing[4] are deficient because they do not provide for payment of "numerous other . . . costs" that Coral Power asserts should be paid to Generating Units that are shut down and re-started. TDM makes a similar assertion. Coral Power at 2-5; TDM at 2.[5] These arguments should be rejected on both procedural and substantive grounds.

(2002); *Duke Energy Corporation*, 100 FERC ¶ 61,251, at 61,886 (2002); *Delmarva Power & Light Company*, 93 FERC ¶ 61,098, at 61,259 (2000).

[3] For convenience, the ISO will use in this answer the same abbreviations for Commission orders and ISO filings that were defined in the Request for Rehearing and Motion for Clarification, and Motion for Stay, that the ISO submitted in this proceeding on February 7, 2005.

[4] These same tariff changes were also contained in the May 17, 2004 Compliance Filing.

[5] According to Coral Power, these numerous other costs include:

> (i) accruals toward turbine major maintenance costs (*e.g.*, as incurred under a Long Term Service Agreement, or "LTSA"), (ii) costs associated with tripping during the startup (*e.g.*, replacement energy and imbalance costs resulting from failure to meet schedule commitments, trip costs incurred under an LTSA, etc.), (iii) costs associated with thermal cycling and other wear-and-tear on balance of plant equipment, (iv) additional fuel consumed during the startup, (v) no-load or

Coral Power's and TDM's contentions are untimely and inappropriate in connection with the ISO's compliance filing. The only question that is relevant to a compliance filing is whether the ISO complied with the wishes of the Commission. The ISO did so, by submitting tariff changes in the February 14, 2005 Compliance Filing to provide for the recovery of Start-Up Costs. **In particular, in its compliance filing, the ISO has provided for recovery of the same Start-Up Costs that the Commission has approved for Must-Offer Generators.** Coral Power's and TDM's desire for *additional* compensation is irrelevant to the issue of the ISO's compliance with the Commission's directives in the January 6, 2005 Order.

Moreover, Coral Power and TDM failed to raise their concerns regarding the insufficiency of the compensation provided in the January 6, 2005 Order in a request for rehearing of that Order. Indeed, the Commission noted a filing in which Coral Power argued that the numerous other costs should be included in Start-Up Costs, but the Commission did not grant that request. *See* January 6,

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> minimum output fuel costs prior to actual market operation and payment for delivered energy, and (vi) calling in additional personnel to carry out the startup.

Coral Power at 5. TDM asserts that Generating Units should be paid for costs that include the following:

> "balance of plant" consumables such as chemicals, water, etc.; fuel burned to move from initial synchronization to minimum load, net of the value of MWH produced; the cost of a failed restart (i.e., lost spark spread plus any penalty resulting from schedule deviations) multiplied by the probability of a failed restart; and wear-and-tear on turbines, boilers, "balance of plant," etc.

Response of TDM to Motion for Clarification of the ISO, Docket No. ER03-683-004 (filed Feb. 22, 2005), at 3 ("TDM Response"). In the TDM protest that the present filing answers, TDM incorporated by reference the TDM Response. TDM at 2.

2005 Order at P 20.[6] Because they failed to challenge that ruling in a timely request for rehearing, Coral Power and TDM may not do so now; their challenges to the ISO's compliance filing amount to untimely rehearing requests.

Coral Power's and TDM's requests are substantively without merit as well, and they go far beyond what the Commission directed in the Amendment No. 50 proceeding. As TDM has conceded (*TDM Response at 2*), the ISO Tariff currently provides that the only Start-Up Costs the ISO will pay are fuel and auxiliary power costs.[7] ISO Tariff, §§ 2.5.23.3.7.1, 2.5.23.3.7.6; ISO Tariff, Appendix A, definition of "Start-Up Costs." These are the only costs that the ISO pays to Must-Offer Generators that are started up. ISO Tariff, §§ 2.5.23.3.7.1, 2.5.23.3.7.6.[8] In the Amendment No. 50 proceeding, the Commission gave no indication that it was requiring the ISO to pay Start-Up Costs to Generating Units that were shut down to manage Intra-Zonal Congestion that went beyond the

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[6] If the Commission believed that the numerous other costs should be included in Start-Up Costs, it presumably would have said so in the January 6, 2005 Order. The list of other costs that Coral Power proposes were presented to the Commission in Coral Power's request for rehearing of the May 17, 2004 Order, but the Commission did not find in the January 6, 2005 Order that those other costs should be included. *See* Coral Power at 5; January 6, 2005 Order at PP 19-20.

[7] In addition, the methodology provided in Equation C1-8 in the Reliability Must-Run ("RMR") Contract (contained in Schedule C to the RMR Contract) includes a 2 percent adder that can account for costs other than daily gas and auxiliary power: Equation C1-8 states that the commodity price "shall be the product of 1.02 and the simple average of" the daily gas indices used by the ISO. The portion of the RMR Contract concerning Equation C1-8 is included in Attachment A to the present filing.

[8] The ISO first proposed tariff changes to permit the recovery of auxiliary power costs in *Amendment No. 60 to the ISO Tariff* ("Amendment No. 60"). *See* Amendment No. 60, Docket No. ER04-835-000 (filed May 11, 2004), at pages 2, 4, and 15 of Attachment B1 (showing black-lined tariff changes); *California Independent System Operator Corporation*, 108 FERC ¶ 61,022, at PP 76, 80 (2004) (order approving the ISO's proposal to include the payment of auxiliary power costs). Those changes became effective July 11, 2004. *California Independent System Operator Corporation*, 108 FERC ¶ 61,022, at ordering paragraph (A).

Start-Up Costs the ISO pays to Must-Offer Generators. *See* April 16, 2004 Order at PP 38, 41; January 6, 2005 Order at P 20.[9]

Coral Power and TDM provide no reason why the ISO should pay different Start-Up Costs to Must-Offer Generators and to Generating Units that have been shut down for Intra-Zonal Congestion Management, and there is none. It would not make sense to provide payment differently in those two cases, because the steps taken to start up a unit are the same in both instances. Indeed, the January 6, 2005 Order did not direct the ISO to pay different Start-Up Costs to units shut down for purposes of managing Intra-Zonal Congestion than the ISO pays to must-offer units. Further, Coral Power and TDM fail to provide any explanation as to how the ISO would even be able to verify all of the numerous other costs that those entities assert should be included in the payment of Start-Up Costs. Nor do they attempt to make any showing that these costs are even appropriate for recovery as Start-Up Costs. In any event, the Commission-approved methodology for Start-Up Costs recovery includes a 2 percent adder. This adder can cover any additional Start-Up Costs that might be incurred.

Coral Power also makes the erroneous assertions that the ISO does not propose to give Generating Units the opportunity to recover auxiliary power costs, intrastate transportation costs, and municipal use fees, and thus that the ISO's proposal is inconsistent with the method contained in Amendment No. 60 for recovery of Start-Up Costs by Must-Offer Generators and RMR generators.

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[9] Moreover, in its orders concerning the payment of Start-Up Costs to Must-Offer Generators, the Commission rejected proposals by parties that the ISO be required to pay a variety of additional cost items to Must-Offer Generators. *San Diego Gas & Electric Co., et al.*, 93

Coral Power at 4-5. As explained above, Generating Units that are shut down and re-started will be permitted to recover their auxiliary power costs pursuant to Sections 2.5.23.3.7.1 and 2.5.23.3.7.6. Further, the ISO *does* propose to allow Generating Units to recover their intrastate gas transportation and municipal use costs.[10] These costs are part of the fuel costs (*i.e.*, the "applicable proxy figure for natural gas costs") recoverable under Section 2.5.23.3.7.6. Therefore, the ISO's proposal is consistent with the recovery of costs approved in Amendment No. 60. *See* California *Independent System Operator Corporation*, 108 FERC ¶ 61,022, at P 80.

For these reasons, Coral Power is wrong that the recovery of costs pursuant to the ISO's proposal in the February 14, 2005 Compliance Filing is inconsistent with the recovery of costs pursuant to Amendment No. 60. In fact, the February 14, 2005 Compliance Filing and Amendment No. 60 are entirely consistent with each other. What *would* create inconsistencies in the treatment of Start-Up Cost recovery for units subject to the must-offer obligation and units shut down to manage Intra-Zonal Congestion is if the Commission were to approve the recovery of the numerous other costs that Coral Power and TDM propose. Those costs are **not** recovered by Must-Offer Generators pursuant to Amendment No. 60, nor should they be recovered by Generating Units that are shut down for Intra-Zonal Congestion Management and then re-started.

FERC ¶ 62,369 (2001), *order on reh'g*, 99 FERC ¶ 61,159, at 61,642 (2002); *San Diego Gas & Electric Co., et al.*, 97 FERC ¶ 61,275, at 62,212-13 (2001).

[10] In fact, an express component of Equation C1-8 (Gas) is the "Intrastate Transportation Rate."

Moreover, Coral Power erroneously characterizes the significance of a proposal made by the ISO in the proceeding concerning Amendment No. 61 to the ISO Tariff ("Amendment No. 61"). Coral Power at 3-4. In the Amendment No. 61 proceeding, the ISO agreed in an answer to comments and protests that it was reasonable to pay the costs of keeping a unit operating (*i.e.*, keeping the unit "warm"), assuming that keeping the unit warm was less expensive than shutting it down and re-starting it.[11] The Commission agreed with the ISO that generators should be compensated "for the costs associated with keeping a unit warm if the unit is needed to meet the next day's schedule and it is economical to do so." *California Independent System Operator Corporation*, 108 FERC ¶ 61,193, at P 16 (2004). To comply with the Commission's directive to provide for such compensation in the ISO Tariff, the ISO proposed the following changes to Section 7.2.6.1 (with the changed text appearing in bolded and underlined format):

> If a Generating Unit is instructed by the ISO to shut down to manage Intra-Zonal Congestion, and is subsequently re-started, the Owner of that Generating Unit may invoice the ISO for the **lesser of (1) the** Start-Up Costs incurred **and (2) the costs of keeping the Generating Unit warm to meet its Energy Schedules** as set forth in Section 2.5.23.3.7.6.

Amendment No. 61 Compliance Filing, Docket No. ER04-938-002 (filed Sept. 16, 2004), at Attachment C.[12] Thus, the ISO simply proposed to pay either the Start-Up Costs or the costs of keeping the unit warm, whichever was less. Coral

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[11] *Motion for Leave to File Answer and Answer of the ISO to Comments and Protests*, Docket No. ER04-938-000 (filed July 26, 2004), at 7.

[12] The Commission has not yet issued an order on the Amendment No. 61 compliance filing.

Power is wrong in asserting that, in proposing the quoted provision, the ISO "necessarily recognizes that the Section 2.5.23.3.7.6 gas costs are invariably less than the costs that a generator must receive to be compensated for its start-up costs." Coral Power at 4. Indeed, the opposite is true. The ISO proposed to pay the costs of keeping a unit warm only to the extent such costs are less than Section 2.5.23.3.7.6 costs. *See* September 16, 2004 Compliance Filing in Docket No. ER04-938. The quoted provision simply requires a comparison between Start-Up Costs and the costs of keeping a Generating Unit warm. The ISO believes that the costs of keeping a Generating Unit warm will be smaller than Start-Up Costs in many cases, but the provision requires the comparison to be made anew in each case where a Generating Unit in instructed to shut down to manage Intra-Zonal Congestion and is subsequently re-started.

Finally, the ISO notes that Coral Power's argument that the ISO should have included provision for the payment of numerous other costs in the February 14, 2005 Compliance Filing is also at odds with the argument that Coral Power made at an earlier stage in this proceeding, when it contended that the "Potomac standard" for identifying competitive periods should be implemented prospectively only pursuant to a Section 205 filing. In that regard, Coral Power earlier argued that a tariff provision that "establishes new rates" or "will have a significant impact on price" should be included in a filing pursuant to Section 205 of the Federal Power Act, and that the new rates "must be placed on file and

accepted before they can be put into effect."[13] Payment of the numerous other costs that Coral Power seeks to recovery would establish new rates and have a significant impact on price. Further, the Commission has not heretofore in this proceeding approved the recovery of such specific costs. Therefore, following Coral Power's earlier argument, if the ISO believed that expansion of the definition of "Start-Up Costs" to include additional cost elements was appropriate – and it does not – it could only implement such a change through a Section 205 filing.

B. The Use of a Daily Gas Index in Calculating Decremental Reference Levels

1. The Daily Gas Index Used by the ISO is Just and Reasonable.

Coral Power is the only intervenor who objects to the daily gas index mechanism proposed by the ISO. TDM does not challenge the appropriateness of that element of the February 14, 2005 Compliance Filing. Coral Power asserts that the Commission should reject the provision in the February 14, 2005 Compliance Filing to employ a six-day lag between (i) when the gas price used in the daily gas index for calculating decremental reference levels is determined, and (ii) when the daily gas index based on that gas price can be calculated. Coral Power also argues that the use of the six-day lag will produce an unreliable daily gas index. Coral Power at 7-8.

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[13] Motion for Leave to File Answer and Answer of Coral Power to ISO Request for Rehearing of January 6, 2005 Order and Answer to ISO Motions for Clarification and Stay, Docket No. ER03-683-007 (filed Feb. 22, 2005), at 8 & n.12 ("Coral Power Answer").

Coral Power misunderstands both the nature of the six-day lag and the reasons the ISO has proposed it. Coral Power asserts that "the ISO is . . . incorrect when it suggests that the lag in calculating gas costs for RMR units is often, if not typically, six days" because "the RMR settlement actually uses an average of two days in [Equation C1-8], not six days." Coral Power at 8. Here Coral Power is confusing two distinct elements of the computation: the length of the period over which gas costs are averaged (two days in Equation C1-8) and the span between that period and when that calculation will be applied (six days in the compliance filing at issue here). Equation C1-8 provides for the calculation of the daily gas index based on a gas price that is a two-day average of gas prices as shown in Table C1-8. **The ISO is proposing to use this same two-day average in the February 14, 2005 Compliance Filing.** However, this two-day average of gas prices is entirely different from the six-day lag to be used in providing the two-day average. In that regard, the daily gas index is a two-day average that will be provided six days after the fact. The Equation C1-8 *methodology always involves a lag in compiling the necessary data and* calculating the index based on the two-day average data. That lag can sometimes be six days. The ISO is standardizing that lag herein.

Coral Power also makes the faulty argument that the ISO "departs from the RMR methodology through its across-the-board six-day lag proposal." Coral Power at 7. Coral Power fails to understand the differences between RMR dispatch generally and dispatch based on decremental reference prices. As a

general rule, it is not necessary to know the gas price to dispatch RMR Units.[14] The gas price is only necessary for settlement purposes. On the other hand, decremental reference levels are used for determining the merit order of decremental dispatches, and therefore must be available in advance.[15]

The ISO notes that it has proposed a six-day "calculation" lag in order to provide a means of determining the daily gas index for calculating decremental reference prices that is uniform, easy to administer, and builds in time for possible delays (*e.g.*, due to server breakdown). The calculation must, in particular, take into account the need for the ISO to calculate the daily gas index for a Friday when the following Monday is a public holiday. In that case, the

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[14] There is only one situation in which the ISO must know the gas price in advance in order to dispatch RMR units, and that is when the ISO must calculate Condition 2 RMR Units' energy bid prices under Schedule M of the RMR Contract. In that situation, the ISO uses the daily gas index, calculated pursuant to Equation C1-8, with a lag of up to six days. This is practically the same calculation methodology as the ISO proposed in February 14, 2005 Compliance Filing.

[15] Coral Power suggests in a footnote that the ISO should determine the gas price using two different and separately calculated reference levels (one determined prior to dispatch and one determined after the fact in settlements), rather than the Commission-approved single, pre-dispatch reference level which the ISO has used since the Commission approved Amendment No. 50 and which the ISO continues to utilize in the February 14, 2005 Compliance Filing. Coral Power at 8 n.6. The Commission should reject Coral Power's suggested approach which would result in an entirely new and different decremental reference price methodology – a methodology that is significantly different from the methodology the Commission previously adopted in this proceeding. It is unclear how a methodology that is different from the one previously approved by the Commission – and with which the ISO must comply – can be implemented as part of a compliance filing.

Stated differently, the Commission has never ordered the ISO to establish two decremental reference levels in this proceeding, one for dispatch and one for settlement. The Commission has previously approved tariff language utilizing a *single* decremental reference level for dispatch and settlement purposes. The ISO has been using that single decremental reference level approach in compliance with the Commission's prior orders and did not propose to alter that approach in the February 14, 2005 Compliance Filing – nor should it have. The ISO also notes that the decremental reference price methodology approved by the Commission in the Amendment No. 60 proceeding makes no provision for the calculation of two reference levels. It only provides for the calculation of a dispatch reference level, not a separate settlement reference level. Moreover, requiring the ISO to conduct two such disparate calculations for determining reference levels would result in needless complication. As explained herein, the use of a single reference level and a six-day lag is reasonable and sufficient.

Monday value will not be available until the next day (Tuesday) to allow for calculation of the index for the preceding Friday. Between Friday and Tuesday there are five days, including the beginning and ending days. And after the daily gas index is calculated it still has to be transmitted to Potomac Economics ("Potomac"), which then has to run its computer program to calculate the decremental reference prices and transmit the results back to the ISO. The ISO then has to load the prices into its systems by 11 a.m. of the day prior to the Trading Day on which the decremental reference prices are to be used. These actions must be completed sequentially and can take an additional day to be completed. Therefore, the means of calculating the daily gas index proposed in the February 14, 2005 Compliance Filing accounts for any delays that may occur, *e.g.*, due to delays in the ISO's becoming aware of price data server outages and/or problems that Potomac Economics may encounter. The use of a six-day lag provides sufficient time for these calculations to be made and to account for problems that may be encountered in the calculation.[16]

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[16] In a footnote Coral Power asserts that, with regard to the duration of the lag, "[a] worst case scenario occurs when Christmas Eve occurs on a Thursday." Coral Power at 7 n.5. If a Thursday and Friday are public holidays (due to the Thanksgiving or Christmas holidays), then the Wednesday prices for the Gas Daily and NGI Daily gas indices are not posted until the next business day – in this case, they are posted at 8:00 a.m. of the Monday after the public holidays. The ISO will need the Wednesday prices referenced above by 11:30 a.m. on Tuesday for the following Wednesday's dispatch, according to the methodology proposed in the February 14, 2005 Compliance Filing. For Potomac to run its reference level calculations and transfer them back to the ISO in time for the Tuesday, 11:30 a.m. cutoff Potomac requires all of the necessary information by 8:00 a.m. at the very latest. This is all presuming that there are no delays of any kind. With a six-day lag, the gas prices would be required by early on Tuesday morning, which would give the ISO fewer than 24 hours to get the information organized, even with the time built in for any delays. Providing such leeway with regard to the daily gas index is a necessary part of any robust proposal, which is what the ISO is advocating. A lag of five days or fewer would be too short and would not provide sufficient leeway.

Also, by using a uniform six-day lag in calculating two-day average prices, the ISO's methodology ensures that reference levels for any day of the week (*e.g.*, a Friday) will incorporate the gas price index from the same day of the previous week (*e.g.*, the previous Friday). Because reference levels for any day of any week will be calculated using the gas price index (and Equation C1-8) for the equivalent day the previous week, the use of a six-day lag is a uniform and easy-to-administer system that preserves any weekly pattern in gas prices.

It is preferable to use a uniform six-day calculation lag as proposed in the February 14, 2005 Compliance Filing rather than a calculation lag that is non-uniform or variable. Because the gas markets are closed on the weekends and some public holidays, the calculation and delivery of daily gas index values is not monotonic, but "lumpy." Due to this lumpiness, if the ISO were to use the most recent gas index available, rather than use a uniform six-day lag, the gas index values determined for certain days of the week might be used more frequently than the gas index values determined for other days of the week. This would introduce a slight bias into the reference levels, especially if natural gas prices have a weekly pattern. The use of a uniform six-day lag overcomes this problem and preserves any weekly patterns in the natural gas market. Therefore, the use of a uniform six-day lag is more reasonable than use of a non-uniform lag. In any event, a lag will always exist when the Equation C1-8 methodology is used, be it a four-, five-, or six-day lag. The ISO is merely providing for a uniform lag when it comes to calculating two-day average prices.

Finally, Coral Power asserts that use of the six-day lag can sometimes result in charges that are "more than what would be the case if the rate accurately reflected the gas index costs for the next day." Coral Power at 8. This contention rests on an inappropriate assumption that is inconsistent and at odds with the decremental reference price methodology that the Commission has previously approved in this proceeding. By "the next day," Coral Power means the day ***after*** the decremental dispatch of a unit occurs. Stated differently, Coral Power seeks to completely overhaul the approach the Commission has approved in this proceeding. This is inappropriate in regard to a compliance filing. The ISO is unable to foretell the future and should not be required to dispatch units based on future prices that have not yet been determined. Further, the ISO should not be in the business of attempting to predict future gas prices. The most appropriate gas price for reference level calculations to be used for unit dispatch on a particular day is based on the gas price index for the day of dispatch, not a day in the future. The gas price for a day in the future cannot be known ahead of time, and if the Commission were to agree with Coral Power's argument the ISO would have to estimate that index price as well. Indeed, Coral Power offers no alternative methodology for calculating future prices. For the reasons explained above, the best estimate involves the ISO's proposed use of the lagged Equation C1-8 methodology to approximate the gas price for the day of dispatch, not a day in the future. Coral Power's argument also ignores the fact that the use of a six-day calculation lag can sometimes result in charges that are *less* than what would be the case if the rate accurately reflected the gas index

costs for the next day. Gas prices do not just go up (as is the case in the example provided by Coral Power to support its argument), they also go down. Over the long term, the occasions on which the lagged prices are greater than the costs for the next day should be counter-balanced by the occasions on which the lagged prices are less than the costs for the next day. As a result, over the long term, Market Participants will neither over-pay nor under-pay costs as a result of the use of the six-day lag.

2. The Commission Should Not Require the ISO to Provide Specific Compensation to Generating Units for Pipeline Penalties and Imbalance Charges.

Coral Power incorrectly asserts that the February 14, 2005 Compliance Filing is deficient in not providing for compensation to shut-down generators for pipeline penalties and imbalance charges. Coral Power at 9-10. The January 6, 2005 Order did not direct the ISO to include such provisions in the compliance filing. *See* January 6, 2005 Order at P 41. Rather, the Commission merely directed the ISO to "incorporate the use of a Commission-approved daily gas index into the calculation of decremental reference levels." *Id.* Indeed, in the relevant ordering paragraph the Commission reaffirmed this by only directing the ISO to "incorporate the use of a Commission-approved daily gas index into the calculation of decremental reference levels." *Id.* at ordering paragraph (F). There is no "Commission-approved daily gas index" that expressly provides for the recovery of pipeline penalties and imbalance charges.

Moreover, the shut-down decremental reference prices approved by the Commission in the Amendment No. 61 proceeding can account for any pipeline

penalties or imbalance charges that Coral Power incurs when shut down by the ISO to manage Intra-Zonal Congestion. Coral Power expressly acknowledges that pipeline penalties and imbalance charges can be incurred "when the ISO orders a unit to shut-down." Coral Power at 9. Further, the examples that Coral Power provides regarding the charges it may incur pertain to the shutting down of the unit, not the starting up of the unit. Thus, Coral Power itself acknowledges that imbalance charges and pipeline penalties are costs a unit may incur for shutting down, not costs a unit will incur for starting up. Such costs are properly a component of the shut-down reference prices, not a component of Start-Up Costs. The Commission has approved a mechanism to account for the incurrence of such costs by approving the ISO's Amendment No. 61 (with modifications). Thus, Generators have an opportunity to include an estimate of such costs, on an *ex ante* basis, in their shut-down reference levels.

The ISO notes that the daily gas index reflected in Equation C1-8 that the Commission approved for Must-Offer Generators in the Amendment No. 60 proceeding – which is the same daily gas index the ISO proposes in the February 14, 2005 Compliance Filing to use for re-started Generating Units – does not provide for the recovery of pipeline penalties or imbalance charges. See Attachment A to the present filing. As explained in Section I.A, above, the compensation provided to Must-Offer Generators should be the same as the compensation provided to Generating Units that are shut down and then started up.

In any event, Equation C1-8 already provides for compensation to Generating Units in the form of a 2 percent adder on their commodity price. That adder can compensate re-started Generating Units for any pipeline penalties and imbalance charges they might incur to start up. Further, if Generators are guaranteed recovery of penalties or imbalance charges, they will not have any incentive to mitigate the incurrence or level of such charges.

C. The Use of a Daily Gas Index in Calculating Decremental Reference Levels Cannot Lawfully Be Made Effective Retroactively.

Coral Power argues that the use of a daily gas index in calculating decremental reference levels should be made effective May 30, 2003, on the ground that it is a "necessary component of the entire RL [reference level] regime" and therefore is a "related necessary change" with regard to the calculation of decremental reference levels. Coral Power at 10-11. Interestingly, Coral Power's position with respect to the use of a daily gas index is flatly inconsistent with its prior advocacy in this proceeding of the application of the Potomac standard on a prospective basis only. In that regard, Coral Power has argued in this proceeding that tariff changes cannot be implemented retroactively where "the compliance filing seeks . . . to implement a 'completely different strategy' in the rates on file" and where "an entirely different rate" is proposed. Coral Power Answer at 9-10. Yet, that is exactly what Coral Power is proposing to do here. It was not until the January 6, 2005 Order was issued that the Commission required the ISO, for the first time, to use a daily gas index in Section 7.2.6.1.1 rather than the monthly gas index that the Commission had

previously approved in the April 16, 2004 Order. January 6, 2005 Order at P 41; April 16, 2004 Order at PP 44-46, 62 (approving Section 7.2.6.1.1 as proposed by the ISO, subject to modifications that did not include changes to the proposed use of a monthly gas index).[17] To comply with the January 6, 2005 Order, the February 14, 2005 Compliance Filing proposed to change the use of the gas index from monthly to daily. Therefore, according to Coral Power's earlier advocacy in this proceeding, the February 14, 2005 Compliance Filing contained a "completely different strategy" for determining decremental reference prices, which would cause the decremental reference prices to be "entirely different" than they would be if the ISO were to continue to use a monthly gas index. Thus, according to Coral Power's earlier arguments, the daily gas index cannot be implemented retroactively. This is consistent with judicial case law that a rate formula can only become effective when the Commission explicitly adopts a formula and indicates when it will take effect. *Transwestern Pipeline Company v. FERC*, 897 F.2d.570, 578 (D.C. Cir. 1990).

Moreover, the use of a daily gas index (rather than a monthly gas index) is not necessary for the determination of decremental reference prices. Indeed, the ISO has used a Commission-approved monthly gas index in the past. In the January 6, 2005 Order, the Commission merely found that "the use of a daily gas index is reasonable" and that "a daily gas price index is more in line with the process of decrementing generators in real time." January 6, 2005 Order

[17] In the April 16, 2004 Order, the Commission noted but did not address one party's contention that the daily gas index should be considered in the decremental reference price methodology. April 16, 2004 Order at P 35. Thus, even though a party expressly proposed the use of a daily gas index, the Commission declined to required its use in that order.

at P 41. That is a far cry from a finding that use of a daily gas index is a related necessary change.[18] Nowhere in the January 6, 2005 Order did the Commission direct the ISO to implement the use of a daily gas index retroactively. Indeed, although the Commission specifically directed the ISO to "provide generators the opportunity to recover start-up costs with an effective date of May 30, 2003," the Commission, in that same ordering paragraph, did not specify any retroactive effective date for the use of a daily gas index. January 6, 2005 Order at ordering paragraph (F).

Further, although the Commission required the use of a daily gas index for determining decremental reference prices in the January 6, 2005 Order, the Commission has not yet approved the specific daily gas index formula that must be used. Arguably, then, the earliest the daily gas index could be implemented is the date that the Commission approves the specific formula to be used. In any event, under no scenario can the Commission approve use of a daily gas index prior to January 6, 2005, *i.e.* the date the Commission approved use of a daily gas index.

The ISO notes that until mid-2004, the Commission's policy was to use a monthly gas index.[19] The Commission did not approve the use of a daily gas index with regard to the calculation of Start-Up Costs of Must-Offer Generators until it issued its July 8, 2004 order in the Amendment No. 60 proceeding. Thus,

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[18] In contrast, the Commission has found in this proceeding that the Potomac standard is "*necessary* to correct a fundamental flaw in the proposed decremental reference bid methodology." April 16, 2004 Order at P 62 (emphasis added).

[19] *See California Independent System Operator Corporation*, 107 FERC ¶ 61,274, at PP 35, 48 (2004) (stating that the ISO had not yet justified use of a daily gas index and a two-day gas price average).

allowing retroactive implementation of a daily gas index back to May 2003 would be flatly contrary to express Commission policy in effect at that time.

Moreover, contrary to Coral Power's assertions, the ISO will not "delay implementation indefinitely" with regard to the daily gas index. Coral Power at 11. The ISO proposed that the clean tariff sheet to implement the use of the daily gas index (First Revised Sheet No. 204B) be made effective "One Day After Notice to Market Participants." The ISO commits to provide the required notice and to implement the use of the daily gas index the following day.

Coral Power also purports to find it "ominous" that First Revised Sheet No. 204B bears an effective date of one day after notice to Market Participants, when that sheet also reflects the deletion of the Potomac standard from the ISO Tariff. Coral Power at 12-13. Coral Power need not have any qualms. Because it is impracticable to specify on that single clean tariff sheet the different effective dates that apply to changes reflected on the sheet, the ISO has simply stated the *latest* effective date for any provision on the sheet, *i.e.*, the effective date for the provision to implement the use of the daily gas index. The specification of that effective date has no bearing on when the deletion of the Potomac standard from the sheet becomes effective.

II. CONCLUSION

WHEREFORE, for the foregoing reasons, the ISO respectfully requests that the Commission grant leave to file the present answer and deny the relief requested by Coral Power and TDM.

Respectfully submitted,

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Filed: March 22, 2005

ATTACHMENT A

The Hourly Fuel Price for Units shall be the same for each hour of a given day and is calculated in accordance with Equation C1-8.

Equation C1-8 (Gas)

Hourly Fuel Price ($/MMBtu) = Commodity Price ($/MMBtu) + Intrastate Transportation Rate ($/MMBtu)

Equation C1-8 (Oil)

Hourly Fuel Price ($/MMBtu) = Commodity Price ($/MMBtu) + Transportation Rate ($/MMBtu)

Commodity Price for Natural Gas

For the Facilities within the service area of SCE or SDG&E, the Commodity Price shall be the product of 1.02 and the simple average of the following indices:

Gas Daily, SoCal Gas, Large Packages index (midpoint)
BTU Daily Gas Wire, SoCal Border index, Topock
NGI Daily Gas Price Index, Southern California Border (average)

For the Facilities within the service territory of PG&E, the Commodity Price shall be the product of 1.02 and the simple average of the following indices:

Gas Daily, PG&E Citygate index (midpoint)
NGI Daily Gas Price Index, PG&E Citygate (average)

The indices to be used for each Settlement Period in a given day are shown in Table C1-8. Where more than one day's index is shown for a Trading Day, the average of the two daily indices should be used. If an applicable index for a day, which is used to compute the index's average for a Trading Day, is not published, then that index will not be used to compute the Commodity Price for that trading day. If no index for a day is published, then the average of applicable indices on the Index Publication Date preceding and the Index Publication Date following such day will be substituted for the Index Publication Date index for that day in Table C1-8. In the event that an index ceases to be published, Parties shall agree on a replacement index.

Table C1-8
Natural Gas Price Indices

	Index Publication Date*		
Trading Day	Gas Daily **	Btu Daily ** Gas Wire	NGI Daily ** Price Index
Tuesday	Tuesday/ Wednesday	Monday/ Tuesday	Tuesday/ Wednesday
Wednesday	Wednesday/ Thursday	Tuesday/ Wednesday	Wednesday/ Thursday
Thursday	Thursday/ Friday	Wednesday/ Thursday	Thursday/ Friday

Friday	Friday/ Monday	Thursday/ Friday	Friday/ Monday
Saturday	Monday/ Tuesday	Friday/ Monday	Monday/ Tuesday
Sunday	Monday/ Tuesday	Friday/ Monday	Monday/ Tuesday
Monday	Monday/ Tuesday	Friday/ Monday	Monday/ Tuesday

* *The Index Publication Date is the date of the publication which contains the prices for the applicable Trading Day.*

** *Where more than one day's index is shown for a Trading Day, the average of the two daily indices should be used.*

Gas Daily: The "Flow Date(s)" column should match the Trading Day.

Btu Daily: The Index Publication Date should be the day prior to the Trading Date in the Table above, except for Sunday and Monday, where Friday should be used as the Index Publication Date.

NGI Daily: The Index Publication Date should be the same as the Trading Date in the tables above, except for Saturday and Sunday, where Monday should be used as the Index Publication Date.

Commodity Price for Distillate Fuel Oil

The Commodity Price for Distillate Fuel Oil shall be the simple average of the midpoint of the ranges for CARB No. 2 Diesel and for Jet as published in Platt's Oilgram United States West Coast Product Assessments (page 22). If the Unit can burn only Jet, the Commodity Price shall be the midpoint of the range for Jet.

In an event the index ceases to be published, the Parties shall agree on a replacement index.

For distillate fuel, the index will be for the last day prior to the RMR Transaction Day.

Commodity Price for No. 6 Residual Fuel Oil

The fuel price shall be the prudent actual replacement cost of the fuel consumed, or, if the fuel is consumed and not replaced, then the fuel price will be "last-in-first-out" (LIFO) inventory price of the fuel consumed.

Where conversion from barrels of Fuel to MMBtu is required, the following conversion coefficients shall be used:

- No. 1 Distillate Fuel Oil - 5.754 MMBtu per barrel;
- No. 2 Distillate Fuel Oil - 5.796 MMBtu per barrel;
- Jet Fuel - 5.650 MMBtu per barrel;
- No. 6 Residual Fuel Oil - 6.258 MMBtu per barrel.

Intrastate Transportation Rate for Gas

The Intrastate Transportation Rate for Gas shall be the applicable intrastate transportation rate determined as follows:

Units served by SDG&E: The Southern California Gas Company intrastate transportation rate (currently GT-SD) plus the volumetric component of the SDG&E gas transportation rate for electric generation service, including the ITCS[4] (currently GTUEG – SD), or any successor rate for electric generation service applicable to deliveries to the Facility, divided by one minus the applicable in-kind shrinkage allowance, if any.

Units served by Southern California Gas: The Southern California Gas Company intrastate transportation rate for firm electric generation service, including the ITCS (GT-F) plus the G-ITC Wheeler Ridge Interconnection Access fee, if applicable, or any successor rate for firm electric generation service applicable to deliveries to the Facility, divided by one minus the applicable in-kind shrinkage allowance, if any.

Units served by PG&E: The PG&E intrastate transportation charge stated in Rate Schedule G-EG, or any successor rate for electric generation service applicable to deliveries to the Facility, divided by one minus the applicable in-kind shrinkage allowance, if any.[5]

Transportation Rate for Distillate Fuel Oil

The Transportation Rate for Distillate Fuel Oil shall be _____. There shall be no Transportation Rate for No. 6 Residual Fuel Oil.

B. ISO Monthly Fuel Imbalance Charge

Levels of Responsibility

Each month, the Owner is responsible for all Nonmarket fuel imbalance charges incurred up to and including 2.25 percent of the ISO Facility Monthly Billed Fuel Cost.

The Monthly Fuel Imbalance Charge is equal to 75% of 1st Tier Imbalance plus 100% of 2nd Tier Imbalances;

Where:

The **1st Tier Imbalances** is that portion of the Monthly Sum of Daily Imbalance Charges which exceeds 2.25 percent of the ISO Facility Monthly Billed Fuel Cost for the Month and is less than or equal to 10.0 percent of the ISO Facility Monthly Billed Fuel Cost for the Month.

The **2nd Tier Imbalances** is that portion of the Monthly Sum of Daily Imbalance Charges which is greater than 10.0 percent of the ISO Facility Monthly Billed Fuel Cost for the Month.

The Monthly Sum of Daily Imbalance Charges is the sum for all days in the month of imbalance charges and similar fees and penalties imposed on Owner (or its fuel supplier

[4] ITCS means Interstate Transition Cost Surcharges.
[5] If the Facility does not qualify for service under Rate Schedule G-EG, the applicable rate shall be given by Rate Schedule G-NT.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list for the captioned proceeding, in accordance with Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Folsom, California, on this 22nd day of March, 2005.

/s/ Anthony Ivancovich
Anthony Ivancovich