**UNITED STATES OF AMERICA**
**BEFORE THE**
**FEDERAL ENERGY REGULATORY COMMISSION**

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| **California Independent System Operator Corporation** | ) | **Docket No. ER01-889-000** |
| | ) | |
| **California Power Exchange Corporation** | ) | **Docket No. ER01-902-000** |
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| **San Diego Gas & Electric Company, Complainant,** | ) | |
| **v.** | ) | **Docket No. EL00-95-006** |
| | ) | **Docket No. EL00-98-006** |
| **Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, Respondents, et al.** | ) | **Docket No. EL00-104-002** |
| | ) | **Docket No. EL00-107-003** |
| | ) | **Docket No. EL01-1-003** |

**ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO REQUEST OF THE "CALIFORNIA GENERATORS" FOR EMERGENCY ORDER**

## I. INTRODUCTION AND SUMMARY

On February 14, 2001, the five largest California generators ("the California Generators" or "Generators") filed a request ("Request") for an emergency order to compel the California Independent System Operator Corporation ("ISO") to "comply" with the Commission's order of February 14, 2001 in this docket. *California Independent System Operator Corp., et al.*, 94 FERC ¶ 61,132 (2001) ("February 14 Order"). According to the California Generators, the ISO has "ignored" the February 14 Order by continuing to insist that generators supply energy in real time, *specifically in response to emergency dispatch orders issued under the ISO Tariff*, without ensuring that all of the

energy produced in response to those orders will be paid for by "creditworthy" buyers. The California Generators "request that the Commission take all appropriate action in order to remedy the ISO's conduct as soon as possible," lest that conduct "further destabilize the California markets and inflict serious harm on the Generators and other suppliers." Request at 8-9. The ISO respectfully suggests that the California Generators' Request is based on a complete mangling of the February 14 Order, a disregard of the ISO Tariff, a callous attitude toward consumers that is diametrically opposed to the historical primacy of reliable service within the electricity industry, and a misrepresentation of where the equities lie in the specific circumstances of emergency dispatch orders.

The February 14 Order addressed only the ISO's proposal to continue accepting Schedules from Scheduling Coordinators despite their failure to meet certain credit standards or post security and was not intended to affect generators' obligation to respond to emergency dispatch orders. That obligation, explicit in the ISO Tariff, is consistent with the historical emphasis within the electricity industry and among regulators upon ensuring reliable service to consumers. The Commission's February 14 Order reflected a balanced approach to the current crisis in California: the Commission maintained the requirement of creditworthy purchasers in the context of the day-to-day types of transactions reflected in Schedules, while also leaving untouched the explicit obligation of suppliers to respond without regard to the creditworthiness of purchasers when the ISO issues an emergency dispatch order to maintain

reliable service. The California Generators' Request, by seeking to convince the Commission to interpret the February 14 Order differently, is at bottom an attempt to circumvent the procedures established by the Federal Power Act ("FPA"). If the California Generators believe that the ISO Tariff's requirement that they respond to emergency dispatch orders without regard to creditworthiness of purchasers is unjust and unreasonable, the proper vehicle for making their case is a complaint under Section 206 of the FPA. Their failure to use the proper vehicle becomes understandable when one notes that the justness and reasonableness of requiring the generators to take some credit risk in emergency situations would have to be considered in the context of the profits they have made by becoming Participating Generators under the ISO Tariff and thus being able to participate in the California markets.

## II. DISCUSSION

The California Generators' entire argument is founded on the erroneous premise that the Commission on February 14 ordered the ISO "to provide a creditworthy counterpart for *all* transactions with third party suppliers." Request at 3 (emphasis added). In fact, the Commission did nothing of the sort. The February 14 Order addressed a narrow situation raised by the ISO's proposed Amendment No. 36: whether the ISO could waive the specific penalties set forth in Section 2.2.7.3 of the Tariff, namely, the denial of the right to submit Schedules, for Scheduling Coordinators who failed to post one of several identified forms of security when their bond and commercial paper ratings fell

below a certain level.[1] The Commission accepted that waiver insofar as it allowed scheduling the loads of SCE and PG&E against their own generation, including any generation under contract to serve their loads, but rejected it insofar as it allowed scheduling of those loads against generation owned by third parties and bid into the ISO or other markets. In other words, under Section 2.2.7.3 of the ISO Tariff, neither SCE nor PG&E may submit Schedules with load partially met by generation obtained through such third-party transactions *unless* the utility has either met the required credit rating or provided one of the specified types of security for its current and anticipated obligations.[2]

The California Generators have attempted to expand the effect of the Commission's order so much that it would destroy the ISO's ability to maintain the reliability of the electricity system in California – which, as the Commission noted, is the ISO's "primary obligation." February 14 Order, slip op. at 10. The

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[1] The ISO submitted Amendment No. 36 on January 4, 2001, after it became apparent that the financial well-being of Southern California Edison Company ("SCE") and Pacific Gas and Electric Company ("PG&E") was deteriorating rapidly. A downgrade in the credit ratings of those companies, and of the California Power Exchange ("PX"), which represented SCE and PG&E as a Scheduling Coordinator (and whose financial well-being in this capacity was linked to that of SCE and PG&E), was inevitable. Under Section 2.2.7.3 of the ISO Tariff, such a downgrade would preclude the ISO from accepting any advance Schedules submitted by the PX, representing those companies, or from one of the companies, unless the PX or company first posted financial security in accordance with Section 2.2.3.2. Section 2.2.3.2 provides in relevant part that a Scheduling Coordinator, Utility Distribution Company, or Metered Subsystem that does not maintain an Approved Credit Rating "shall be subject to the limitations on trading set out in Section 2.2.7.3" of the ISO Tariff. Under Section 2.2.7.3, the only limitations on trading concern the inability of such entities to have their Schedules accepted by the ISO if they have not maintained the security required by Section 2.2.3.2.

[2] "We accept the amendments to the extent they allow PG&E and SoCal Edison to continue to *schedule* transactions from generation and over transmission they own to serve their own load. We deny the amendments to the extent they allow PG&E and SoCal Edison to continue to *schedule* transactions from third-party suppliers without adequate assurance of payment. We clarify that PG&E and SoCal Edison may continue to *schedule* third-party transactions if they obtain financial backing from creditworthy counterparts. These actions, in the aggregate, should help in maintaining the reliability of system operations and in encouraging entry of lower-cost supply into California markets." February 14 Order, slip op. at 1-2 (emphasis added).

California Generators do not deny that generators must respond to the ISO's emergency dispatch orders if the ISO is to be able to fulfill that primary obligation. Yet they would have the Commission rule that they do not have to respond unless they can be absolutely assured of payment at the moment the emergency order is issued. The February 14 Order did not give them that carte blanche authority to hold the reliability of the California electricity system hostage to their economic interests – *and the Order could not have done so without completely rewriting the ISO Tariff and ignoring the fundamental concern for reliability of electricity service that not only is reflected in the Tariff but also permeates other documents governing the electricity infrastructure.*

The relevant portions of the ISO Tariff could not be more clear. Section 4.1.2 states: "The ISO shall operate the ISO Controlled Grid . . . in a manner which ensures safe and reliable operation." Section 5.1.3 states: "Each Participating Generator shall take, at the direction of the ISO, such actions affecting such Generator as the ISO determines to be necessary to maintain the reliability of the ISO Controlled Grid. Such actions shall include . . . (a) compliance with the ISO's Dispatch instructions. . . ." Section 5.6.1 states: "The ISO shall . . . have the authority to instruct a Participating Generator to bring its Generating Unit on-line . . . or increase . . . the output of the Generating Unit . . . if such an instruction is reasonably necessary to prevent an imminent or threatened System Emergency . . . ." And Section 11.2.4.2.1 states: "[T]he ISO may, at its discretion, dispatch any Participating Generator . . . that has not bid into the Imbalance Energy or Ancillary Services markets . . . to prevent or relieve

a System Emergency." Those sections are straightforward and categorical; they do not say that the ISO's authority or the generator's obligation is conditioned on there being "creditworthy" purchasers for the energy generated, and the California Generators cite no other provision of the ISO Tariff that establishes, or even intimates, such a condition. The only sections of the ISO Tariff cited in the California Generators' Request are ones establishing the proposition that SCE and PG&E are responsible for paying for part of the energy produced in response to emergency dispatch orders. Request at 7-8. But nothing in those provisions conditions the obligation of Participating Generators to respond to ISO dispatch instructions upon the compliance of those responsible for payment with the credit standards applicable to forward Schedules.

The provisions of the ISO Tariff that clearly require generators to respond to emergency dispatch instructions reflect the fundamental concern for reliability that is embedded in the agreements and specifications that have governed the operation of the electricity system for years – perhaps since the beginning of this society's utter dependence on electricity. Those documents establish that every conceivable step must be taken to balance load in real time by increasing generation, before blackouts are ordered. Specifically, the ISO is obligated to comply with applicable reliability criteria established by the North American Electric Reliability Council ("NERC") and the Western System Coordinating Council ("WSCC").[3] The NERC Operating Manual states in Policy 5 on

[3] For example, Section 2.3.1.1.6 of the ISO Tariff states that the ISO should be WSCC security coordinator for the ISO Controlled Grid. Section 2.1 of the Dispatch Protocol of the ISO Tariff provides that the ISO shall exercise control in compliance with all Applicable Reliability Criteria including the standards established by NERC and the WSCC.

Insufficient Generating Capacity that "[a] control area anticipating an operating capacity emergency shall bring on all available generation, postpone equipment maintenance, schedule interchange purchases well in advance, and prepare to reduce load." Under a heading called "Requirements," the control area is to use generation and transmission facilities "to the fullest extent practicable" and only if "all other steps prove inadequate" should the control area implement manual load shedding. The WSCC Minimum Operating Reliability Criteria ("MORC") provide on page 8 that "[c]ontinuity of service to load" is the primary objective of the Minimum Operating Reliability Criteria." In MORC Section 5 on Emergency Operations under part C on insufficient generating capacity it states that a control area is considered deficient when (1) all available generating capacity is loaded, (2) all operating reserve is utilized, (3) all interruptible load and interruptible exports have been interrupted, (4) all emergency assistance from other control areas is fully utilized and Area Control Exchange is negative and cannot be returned to zero in the next ten minutes -- in this case, after all other steps to maintain reliability have proved insufficient, "it will be necessary to shed firm load without delay."

In the face of the clear command of the ISO Tariff, and the obvious intent of that command to reinforce the underlying commitment to reliable service of those who operate and regulate the electricity system, what do the California Generators offer as justification for their position that they should be permitted to ignore an emergency dispatch order unless they can be absolutely assured of payment? The essence of their argument is that it would be "absurd" for the

Commission to rule that there must be creditworthy counterparties to the generators' voluntary transactions, such as those included in Schedules, but not in the context of "compulsory sales, such as emergency dispatch or OOM [out-of-market] calls." Request at 8. The absurdity results in their view because, in the context of these compulsory transactions, they cannot "mitigate their risk" by themselves finding a rock-solid counterparty or refusing to sell. *Id.* So, in essence, they turn to the Commission to mitigate that risk for them by requiring the ISO to produce that rock-solid counterparty every time it issues an emergency dispatch order in an effort to keep California's lights on. But what the California Generators characterize as absurd is nothing more than the distinction drawn by the ISO Tariff between voluntary forward transactions and emergency actions in real-time, a distinction perfectly in keeping with the historical concern for reliability, and a distinction approved by this Commission when it approved the Tariff.[4]

With all due respect, the ISO submits that what is absurd is the rather unusual view of the world that the California Generators ask this Commission to adopt. In essence, their position is that purely commercial considerations should prevail over everything else, including system reliability. The California

[4] Of course, the California Generators do attempt to bolster their argument by sprinkling their Request with excerpts from the February 14 Order that have been wrenched out of context. None of the phrases they quote (for example, "inappropriate unilateral shifting of unacceptable financial risks," *see* Request at 8) were used by the Commission in the context of emergency dispatch orders. The only reference to emergency dispatch orders in the February 14 Order is the Commission's statement that it hoped the need for them would be reduced by its Order. February 14 Order, slip op. at 13. The Commission's reference to reducing the need for emergency dispatch orders indicates to the ISO that the Commission recognized that they are the last line of defense for system reliability and that the generators' obligation to respond to them is critical to maintaining system reliability.

Generators would have the Commission rule that the *possibility* that suppliers might not eventually receive 100 cents on the dollar for every kilowatt-hour of energy should prevail over the *absolute and immediate need of the system for energy to avoid blackouts*. That preference for commercial interests is not reflected in the ISO Tariff, nor is it consistent with the steady preference for reliable service found in every document governing the electricity system. The California Generators purchased their plants against the backdrop of that preference for reliable service, and each of them signed a Participating Generator Agreement with the ISO Tariff reading exactly as it does today on the issue of emergency dispatch orders and the obligation of Participating Generators to respond as needed to satisfy reliability criteria in the event of an imminent or threatened System Emergency. They cannot obscure these facts by smokescreens of rhetoric such as their "absurdity" argument.

The California Generators contend that the relief they seek from the Commission will help to stabilize the California energy market by "ensur[ing] that suppliers large and small" will produce energy. The first response is that the ISO Tariff, as approved by this Commission, already assures that they will produce if necessary to maintain reliable service in real time and the ISO has gone to court to enforce the generators' obligation and will do so as much as necessary. But the Generators' argument raises a much larger point. It is essential for the Commission to appreciate what the California Generators are really trying to do with their Request. Everyone knows that California's public officials are negotiating with generators on various fronts as part of the effort to correct the

untenable situation with the state's electricity system. Those officials not only are trying to sign up generators to long-term contracts, but also to buy energy from generators from day to day, using state money, to supply the needs of consumers in SCE's and PG&E's service areas. One can easily imagine the increased bargaining leverage the California Generators would gain in both sets of negotiations if this Commission were to rule, in effect, that despite the clear language of the Tariff and the obvious primacy placed on reliable service throughout the entire fabric of the electric system, the ISO could no longer require a generator to produce in a real-time emergency without first negotiating credit assurances acceptable to the generator. It is exactly that leverage that the California Generators are trying to obtain from this Commission.

In accusing the Generators of seeking bargaining leverage through their filing, the ISO is not disregarding the Generators' understandable desire to have iron-clad assurance of receiving full payment for every kilowatt-hour they produce -- *rather, the ISO is only giving that desire appropriate weight under the circumstances.* First, the California Generators are magnifying out of all proportion even the instance of their risk of nonpayment for real-time energy. Over the last several weeks of intense crisis, the ISO has been able to reduce the frequency of real-time emergency dispatch orders; the *availability* of its authority to issue those orders has apparently been sufficient to induce agreement on terms between the generators and the state. Of course, when the ISO needs even a small amount of emergency energy it must receive it in order to avoid blackouts and potential system instability, but the point is that from the

California Generators' standpoint they are not currently being put at risk of nonpayment for a significant amount of energy.

Second, even when called to address a real-time emergency, a generator is not facing a certainty of nonpayment – far from it. The newspapers in California are filled daily with stories recounting the efforts being made to ensure SCE's and PG&E's capability to pay their debts. At least as long as the generators are not seen to be leveraging real-time emergencies for their own commercial interests, one would assume the interest in seeing that the utilities' creditors are paid will continue and the efforts to meet the utilities' debts will eventually bear fruit.

Third, at least in the case of the generators signing the Request, one need not be overly concerned that the risk of nonpayment for emergency energy, to whatever extent it actually exists, might seriously undermine their business (as opposed to perhaps nicking their stock price temporarily). These generators have profited in truly astonishing magnitudes from their entry into the California market.[5] The purpose of pointing out those profits is not that they might have

[5] Southern Energy Inc. reported earnings for 2000 of $366 million – a 36% increase over their 1999 earnings of $270 million (Press Release of Southern Energy Inc., "Southern Energy Reports a 36 Percent Increase in Earnings for 2000" (January 19, 2001)); Reliant Energy's wholesale energy group reported an operating income for 2000 of $482 million – more than a 1700% increase over 1999 operating income (Press Release of Reliant Energy, "Reliant Energy's Wholesale Energy Businesses and Operations Drove Earnings Up 65 Percent for the Year 2000" (January 26, 2001)); Williams Energy Marketing and Trading reported profits for 2000 of $1,008 million – a 970 % increase over reported profit of $104 million for 1999 (Press Release of Williams, "Williams' 2000 Results From Continuing Operations Quadruple 1999" (February 5, 2001)); Duke Energy's North American Wholesale Energy segment reported $528 million in earnings before interest and taxes ("EBIT") in 2000 – a 153% increase over 1999 EBIT, and these results exclude $110 million in receivables for energy sales in California markets (Press Release of Duke Energy, "Duke Energy Exceeds Expectations With 17-Percent Increase in Ongoing Year-End Earnings Per Share," (January 18, 2001); and Dynegy Marketing and Trade reported a recurring net income of $355 million in 2000 – a 252% increase over reported 1999

been garnered through prices charged contrary to law, although that possibility does seem real – as the Commission itself has recognized.[6] Rather, the point is that, however gained, those profits certainly cushion the California Generators against any failure ultimately to realize every penny on their emergency sales during this unprecedented crisis.

Against the appropriately discounted commercial concerns of the California Generators the Commission must consider the interests of those whom it is primarily charged with protecting – the consumers. The FPA's ultimate purpose is to protect consumers.[7] In this respect, the FPA is no different from the other documents forming the infrastructure of the electric system, and no

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recurring net income of $101 million (Press Release of Dynegy, "Dynegy Triples Recurring Net Income in 2000" (January 23, 2000).

[6] Since late summer 2000, an intensive investigation of the California electricity markets has taken place in a proceeding before the Commission. On two separate occasions since mid-fall of 2000, the Commission has found that the prices charged in those electricity markets have been unjust and unreasonable. First, in a decision rendered November 1, 2000, the Commission stated that "[t]he Commission finds in this order that the electric market structure and market rules for wholesale sales of electric energy in California are seriously flawed and that these structures and rules, in conjunction with an imbalance of supply and demand in California, have caused, and continue to have the potential to cause, unjust and unreasonable rates for short-term energy . . . under certain conditions." 93 FERC ¶ 61,121, at 61,349. After accepting numerous extensive written comments on its November 1 decision and holding two public meetings to accept oral comments , the Commission on December 15, 2000 issued a final order in the investigative proceeding. The Commission found that despite the comments and additional evidence presented, "nothing has been presented that would cause us to change the findings in the November 1 Order." 93 FERC ¶ 61,294, at 61,998. The Commission noted that "a variety of factors have converged to drastically skew wholesale prices under certain conditions," *id.*, and that "going forward, we have no assurance that rates will not be excessive relative to the benchmarks of producer costs or competitive market prices." 93 FERC ¶ 61,294, at 61,998-99. The Commission concluded that "we reaffirm our findings that unjust and unreasonable rates were charged and could continue to be charged unless remedies are implemented." *Id.*, at 61,999.

[7] Courts have recognized that the statutory aim is "to protect consumers from exorbitant prices and unfair business practices." *Public Sys. v. FERC,* 606 F.2d 973, 979 n.27 (D.C. Cir. 1979). *See also Atlantic Refining Co. v. Publ. Serv. Com'n,* 360 U.S. 378, 388 (1959) (the corresponding provisions of the Natural Gas Act "afford consumers a complete, permanent and effective bond of protection from excessive rates and charges"); *Pennsylvania Water & Power Co. v. FPC,* 343 U.S. 414, 418 (1952) (describing the Commission's primary duty to "protect consumers against excessive prices").

different from the provisions of the ISO Tariff addressing a generator's obligation to respond to emergency dispatch orders. Consumers will be presented the choice of accepting blackouts or paying whatever generators demand if the California Generators succeed in the real purpose of their Request – to enlist this Commission in support of their profit-maximizing endeavors. Nothing in the ISO Tariff, in previous Commission orders, in any of the laws or other documents governing the industry in which these generators operate, nor in equity or good conscience, supports what the California Generators are seeking in their Request. The relief they request should be denied, emphatically.

One final note. The California Generators' filing amounts to an argument that the ISO Tariff's requirement that they respond to emergency dispatch orders is unjust and unreasonable unless they are given iron-clad assurance of payment for their energy. The California Generators may make such a claim, but to do so they must file a complaint under Section 206 of the FPA, rather than seek to have the Commission rule that it already has made the desired finding *sub silentio* in the February 14 Order. The ISO would welcome a Section 206 filing on this point, for the first issue to be addressed would be whether the Tariff's current requirement that generators respond despite some payment uncertainty is unjust and unreasonable. That issue could only be analyzed in the context of the California Generators' total financial profile in the California market, since it is only through compliance with the ISO Tariff that generators gain access to the transmission grid and thus that market. In light of the profits the generators have earned in that market, it is exceedingly unlikely that the generators could

establish that it is unjust and unreasonable to require them – as part and parcel of earning those profits – to respond to emergency dispatch orders as a last resort to keep the lights on, even if there is some chance they may not be paid in full for their energy.

## III. CONCLUSION

For the reasons set forth in this response, the Commission should deny the California Generators' Request for an emergency order and reaffirm the obligation of generators to respond to the ISO's emergency dispatch orders.

Respectfully submitted,


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Dated: February 27, 2001

## CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing document upon all parties on the official service list compiled by the Secretary in the above-captioned proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010).

Dated at Washington, DC this 27th day of February, 2001.

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Sean A. Atkins