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August 11, 2003

Hon. Magalie Roman Salas, Secretary  
Federal Energy Regulatory Commission  
888 First Street, N.E.  
Washington, D.C. 20426

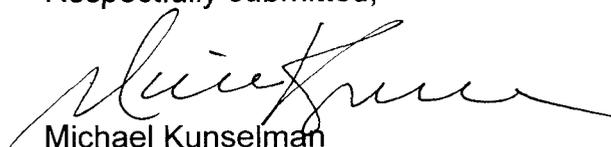
**Re: *American Electric Power Service Corporation, et al.***  
**Docket Nos. EL03-137-000, et al.**

Dear Secretary Salas:

Enclosed for filing are one original and fourteen copies of the Answer of the California Independent System Operator Corporation to Certain Requests for Rehearing of the Order to Show Cause Concerning Gaming and/or Anomalous Market Behavior, submitted in the above-captioned proceeding.

Also enclosed are two extra copies of the request to be time/date stamped and returned to us by the messenger. Thank you for your assistance. Please contact the undersigned if you have any questions regarding this filing.

Respectfully submitted,



Michael Kunselman

Counsel for the California Independent  
System Operator Corporation

Enclosures

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

|   |                         |
|---|-------------------------|
| American Electric Power Service Corporation )   | Docket No. EL03-137-000 |
| Aquila, Inc. )                                  | Docket No. EL03-138-000 |
| Arizona Public Service Company )                | Docket No. EL03-139-000 |
| Automated Power Exchange, Inc. )                | Docket No. EL03-140-000 |
| Bonneville Power Administration )               | Docket No. EL03-141-000 |
| California Department of Water Resources )      | Docket No. EL03-142-000 |
| California Power Exchange )                     | Docket No. EL03-143-000 |
| Cargill-Alliant, LLC )                          | Docket No. EL03-144-000 |
| City of Anaheim, California )                   | Docket No. EL03-145-000 |
| City of Azusa, California )                     | Docket No. EL03-146-000 |
| City of Glendale, California )                  | Docket No. EL03-147-000 |
| City of Pasadena, California )                  | Docket No. EL03-148-000 |
| City of Redding, California )                   | Docket No. EL03-149-000 |
| City of Riverside, California )                 | Docket No. EL03-150-000 |
| Coral Power, LLC )                              | Docket No. EL03-151-000 |
| Duke Energy Trading and Marketing Company )     | Docket No. EL03-152-000 |
| Dynegy Power Marketing, Inc., )                 | Docket No. EL03-153-000 |
| Dynegy Power Corp., El Segundo Power LLC, )     |                         |
| Long Beach Generation LLC, Cabrillo )           |                         |
| Power I LLC, and Cabrillo Power II LLC )        |                         |
| Enron Power Marketing, Inc. )                   | Docket No. EL03-154-000 |
| and Enron Energy Services, Inc. )               |                         |
| F P & L Energy )                                | Docket No. EL03-155-000 |
| Idaho Power Company )                           | Docket No. EL03-156-000 |
| Los Angeles Department of Water and Power )     | Docket No. EL03-157-000 |
| Mirant Americas Energy Marketing, LP, Mirant )  | Docket No. EL03-158-000 |
| California, LLC, Mirant Delta, LLC, and )       |                         |
| Mirant Potrero, LLC )                           |                         |
| Modesto Irrigation District )                   | Docket No. EL03-159-000 |
| Morgan Stanley Capital Group )                  | Docket No. EL03-160-000 |
| Northern California Power Agency )              | Docket No. EL03-161-000 |
| Pacific Gas and Electric Company )              | Docket No. EL03-162-000 |
| PacifiCorp )                                    | Docket No. EL03-163-000 |
| PGE Energy Services )                           | Docket No. EL03-164-000 |
| Portland General Electric Company )             | Docket No. EL03-165-000 |
| Powerex Corporation )                           | Docket No. EL03-166-000 |
| (f/k/a British Columbia Power Exchange Corp.) ) |                         |
| Public Service Company of Colorado )            | Docket No. EL03-167-000 |
| Public Service Company of New Mexico )          | Docket No. EL03-168-000 |
| Puget Sound Energy, Inc. )                      | Docket No. EL03-169-000 |
| Reliant Resources, Inc., )                      | Docket No. EL03-170-000 |

|  |   |                         |
|--|---|-------------------------|
| Reliant Energy Power Generation, and   | ) |                         |
| Reliant Energy Services, Inc.          | ) |                         |
| Salt River Project Agricultural        | ) | Docket No. EL03-171-000 |
| Improvement and Power District         | ) |                         |
| San Diego Gas & Electric Company       | ) | Docket No. EL03-172-000 |
| Sempra Energy Trading Corporation      | ) | Docket No. EL03-173-000 |
| Sierra Pacific Power Company           | ) | Docket No. EL03-174-000 |
| Southern California Edison Company     | ) | Docket No. EL03-175-000 |
| TransAlta Energy Marketing (U.S.) Inc. | ) | Docket No. EL03-176-000 |
| and TransAlta Energy Marketing         | ) |                         |
| (California), Inc.                     | ) |                         |
| Tucson Electric Power Company          | ) | Docket No. EL03-177-000 |
| Western Area Power Administration      | ) | Docket No. EL03-178-000 |
| Williams Energy Services Corporation   | ) | Docket No. EL03-179-000 |

**ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR TO  
CERTAIN REQUESTS FOR REHEARING OF THE  
ORDER TO SHOW CAUSE CONCERNING  
GAMING AND/OR ANOMALOUS MARKET BEHAVIOR**

Pursuant to Rule 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2003), The California Independent System Operator Corporation (“ISO”) hereby submits its Answer to requests for rehearing and or clarification of the Commission’s Show Cause Order<sup>1</sup> filed by the Indicated Generators (“Generators”)<sup>2</sup> and Duke Energy North America, LLC, et al. (“Duke”) in this proceeding on June 25, 2003.<sup>3</sup> Specifically, the ISO responds to allegations made by the Generators and Duke with respect to the issue of Double-Selling.

<sup>1</sup> American Electric Power Service Corporation, *et al.*, 103 FERC ¶ 61,345 (2003) (“Show Cause Order”).

<sup>2</sup> The Indicated Generators consist of subsidiaries of Dynegy, Mirant and Williams.

<sup>3</sup> Although the Commission’s rules normally prohibit answers to requests for rehearing, the Commission has accepted answers to requests for rehearing that assist the Commission’s understanding and resolution of the issues raised in a request for rehearing (*see, e.g., 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 (*see, e.g., 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

I. **ANSWER**

A. **Double-Selling of Ancillary Services Does Constitute a Violation of the ISO's MMIP, as well as the Ancillary Services Provisions of the ISO Tariff**

In the Show Cause Order, the Commission found that the practice of Double Selling, defined as "selling ancillary services in the day-ahead market from resources that were initially available, but later selling those same resources as energy in the hour-ahead or real-time markets," violated the MMIP because they "unfairly took advantage of the market rules by using false representations and/or receiving payments for services that they did not provide." Show Cause Order at P 50-51. The Commission also concluded that Double Selling violated Section 2.5.22.11 of the ISO Tariff, which requires that resources that have been committed to provide ancillary services for a given period must be available and capable of providing the services for the full duration of the period. *Id.* at P 51.

In their request for rehearing, the Generators argue that Double Selling did not violate the MMIP. They contend that the practice of selling energy from ancillary services capacity was "common and known to all," and that, prior to implementation of Amendment No. 13 to the ISO Tariff, which eliminated the possibility of double-payment for ancillary services, neither the ISO nor the Commission had previously suggested that Double Selling was prohibited. Therefore, Generators contend, such sales were "wholly consistent with the filed rate when made." Indicated Generators' Joint Request for Rehearing, Docket Nos. EL03-153-000, *et al.* at 27-28 (July 25, 2003).

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FERC ¶ 61,296 (1995), *modified*, 72 FERC ¶ 61,167 (1995), *vacated on other grounds*, 75 FERC ¶ 61,108 (1996), 78 FERC ¶ 61,163 (1997). This answer should accordingly be accepted as a response to the Generators and Dukes' requests for rehearing.

Generators are incorrect. Double-Selling constituted a violation of the ISO Tariff (including the MMIP) even prior to the effective date of Amendment No. 13. This reality has been recognized by both the ISO and the Commission. In the ISO's transmittal letter accompanying Amendment No. 13, the ISO noted:

If the ISO is to meet Applicable Reliability Criteria, capacity successfully bid into the ISO's Ancillary Services markets must be unloaded, available, and capable of meeting the terms of its bids when called. If a generator produces energy using capacity already committed to the ISO as reserves for Ancillary Services, such capacity is not available for dispatch by the ISO. The unavailability of Ancillary Services capacity when called upon can cause considerable operating difficulties, can raise costs, and can cause a violation of WSCC and NERC policies. *Even if the ISO does not dispatch the capacity from a winning bid in the Ancillary Services auction, the capacity is obligated to be unloaded and available to the ISO.*

Transmittal Letter, Tariff Amendment No. 13, filed in Docket No. ER99-896-000 at 2-3 (Dec. 11, 1998) (emphasis added). The obligation referred to in the emphasized portion of the above quotation is contained in several sections of the ISO Tariff. For instance, pursuant to Section 2.5.21, Ancillary Service Schedules "represent binding commitments made in the markets between the ISO and the Scheduling Coordinators concerned." Moreover, Section 2.5.27, which sets forth the Scheduling Coordinators' entitlement to payment for Ancillary Services, states that the ISO will make payment to Scheduling Coordinators *providing* each of the Ancillary Services. Further, the ISO Scheduling Protocol allows payment only for capacity that is "made available."<sup>4</sup> The obligation to keep Ancillary Service capacity unloaded and available was also addressed in a market notice issued by the ISO on July 17, 1998.<sup>5</sup>

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<sup>4</sup> ISO Scheduling Protocol, Sections 9.6.2, 9.7.2, and 9.8.2.

<sup>5</sup> A copy of this Market Notice is attached as Appendix A.

The Commission agreed with the ISO's explanation of suppliers' obligations under the ISO Tariff prior to the implementation of Amendment No. 13. In the Commission's order approving Amendment No. 13, the Commission framed the proposed tariff modifications as "Changes to Encourage Compliance with the ISO Tariff." *California Independent System Operator Corporation*, 86 FERC ¶ 61,122, 61,417 (1999) ("February 9 Order"). Moreover, the Commission, in approving the Tariff modifications that eliminated the potential for double payment, explained that those changes would "ensure that Ancillary Service providers will have *no economic incentive to dishonor their commitments and a strong incentive to honor them.*"<sup>6</sup> The Commission also remarked that "[w]ithholding the energy imbalance payment removes the economic incentive for Ancillary Service providers to violate their obligations, while removing the compensation for Ancillary Services that were not provided as promised, creates a strong incentive for generators to honor their obligations." *Id.*

Both the Commission and the ISO viewed the practice of Double-Selling as a violation of the ISO Tariff even before the changes made in Amendment No. 13 went into effect. In the Show Cause Order, the Commission correctly identified that this behavior also violated the MMIP because it took unfair advantage of the market rules in place at the time in order to receive payment for a service that they did not provide. Such activity falls within the MMIP's provisions concerning gaming and anomalous market behavior. The Commission should therefore reject the Generators' baseless request for rehearing on this issue.

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<sup>6</sup> *Id.* (emphasis added).

**B. The Sale of Energy from Capacity Committed to Provide Replacement Reserves Constitutes Double-Selling, Even if the Sale was Made in the 60-Minute Period Prior to When the Unit was Committed to Provide Energy from that Capacity**

Duke Energy, on rehearing, advances a narrower argument concerning Double Selling. Duke contends that the Commission erred in concluding that Double Selling constitutes a Gaming Practice to the extent that it determined that a seller of Replacement Reserves was obligated to keep unloaded the capacity committed as Replacement Reserves for the entire 60 minute period prior to when the supplier was obligated to provide requested Energy from the capacity sold as Replacement Reserves. Duke argues that no such obligation existed under the ISO Tariff prior to the implementation of Amendment No. 13 in September, 2000.

In making this argument, Duke Energy entirely ignores the Tariff provisions described above, which provide that the ISO will make payments *only* for Ancillary Service capacity that is *made available*. The ISO Tariff makes no exceptions. Thus, these Tariff provisions apply to all of the various types of Ancillary Services, including Replacement Reserves. As with the other kinds of Ancillary Services, the capacity the ISO has purchased in the form of Replacement Reserves is solely at the ISO's discretion to dispatch, and the supplier has an obligation to keep that capacity unloaded, including during the 60-minute period after the ISO dispatches calls on that capacity. Again, as explained above, the Commission, in the February 9 Order, confirmed that this obligation existed for suppliers even prior to the changes implemented in Amendment No. 13. Duke Energy's arguments that capacity payments

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for Replacement Reserves should be exempt from rescission should therefore be rejected.<sup>7</sup>

### III. CONCLUSION

Wherefore, the ISO requests that the Commission rule consistent with the ISO's positions as expressed in the foregoing sections.

Respectfully submitted,



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Dated: August 11, 2003

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<sup>7</sup> Duke Energy also argues that the ISO's July 17, 1998 market notice, which the ISO relied on in its Amendment No. 51 filing to support the recession of payments for unavailable Ancillary Services, including Replacement Reserves, only concerned Operating Reserve, not Replacement Reserve. Duke Rehearing at 13. Duke Energy ignores the fact that the market notice was specifically addressed to all of the Market Participants "regarding Operating Reserve and Other Ancillary Services." Appendix A at 1.

**APPENDIX A**  
**MARKET NOTICE**

**Market Notice Posted on July 17, 1998:**

**Notice to All Market Participants Regarding Operating Reserve and Other Ancillary Services**

As we move into high load days, there are two items that need to be mentioned as a reminder to all market participants.

- 1) Operating reserve is increasingly important. In order to maintain the reliability of the ISO Control Area, we must maintain proper operating reserve. Reliability of the grid is our most important function.
- 2) Ex-post energy prices are getting higher. This tends to incent market participants to generate above their schedules in order to capture the benefits of a high ex-post price for a particular hour.

Spinning and Non-Spinning Reserve are, by definition, unloaded capacity available in ten minutes. When the ISO purchases these services, it requires that the unit from which they are purchased retain *unloaded* capacity, in the amounts selected in the auctions, to provide these services if and when called. The only exception would be units subject to the physically interdependent unit procedure, such as watershed bids, *etc.*

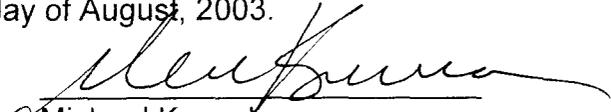
The ISO Tariff specifies certain penalties for failure to provide Ancillary Services sold at auction to the ISO. The ISO intends to pursue these sanctions as required to ensure adequate Operating Reserve is maintained. We understand that some market participants may be interpreting the temporary suspension language of Tariff Section 26 as having eliminated penalties in all cases. As the ISO transmittal letter to FERC and the Board action authorizing the Tariff amendment made clear, this temporary suspension of sanctions applies only to units whose output was adjusted by Congestion Management to a level that conflicts with their Ancillary Service capacities.

Jeffrey D. Tranen  
President and CEO, California ISO

## 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, D.C. this 11th day of August, 2003.

  
Michael Kunselman