UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company	)	**Docket No. EL00-95-000**
v.	)	
Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange	)	
Investigation of Practices of the California Independent System Operator and the California Power Exchange	)	**Docket No. EL00-98-000**
California Independent System Operator Corporation	)	**Docket No. RT01-85-000**
Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Western Systems Coordinating Council	)	**Docket No. EL01-68-000**

ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO MOTION FOR CLARIFICATION OF THE CITIES OF ANAHEIM, AZUSA, BANNING, COLTON, AND RIVERSIDE, CALIFORNIA

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2000) and the Commission's May 18, 2001, Notice Shortening Answer Period, the California Independent System Operator Corporation ("ISO")[1] hereby submits its Answer to the Motion for Clarification, Request for Shortening of Time to Answer, and Request for Expedited

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

Consideration on Behalf of the Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California (hereafter "Southern Cities" and "Southern Cities Motion").

I. BACKGROUND

In the Commission's April 26, 2001 "Order Establishing Prospective Mitigation and Monitoring Plan for the California Wholesale Electric Markets and Establishing an Investigation of Public Utility Rates in Wholesale Western Energy Markets" in the above-captioned dockets, 95 FERC ¶ 61,115, ("April 26 Order"), the Commission, *inter alia*, established a requirement for all sellers that own or control generation in California to offer all their available power in the ISO's real-time Energy market.

In their Motion, Southern Cities request that the Commission condition the obligation of publicly-owned entities to comply with the April 26 Order's must-offer requirement upon ISO assurances of creditworthy buyers to pay for Energy dispatched pursuant to the must-offer requirement. Southern Cities contend that, in the absence of such additional assurances, "requiring publicly-owned systems to offer energy to the ISO will violate applicable restrictions against gifts of public funds." Southern Cities Motion at 2.

II. ANSWER

Southern Cities state that they "are committed to taking any actions possible and consistent with their obligations to their native load customers to assist in responding to crisis that currently afflicts the California energy markets and is expected to intensify in the coming months." Southern Motion at 2. As an initial matter, the ISO acknowledges the contribution of public entities such as the

Southern Cities in responding to the crisis in California to date and applauds Southern Cities' commitment to make their Energy available to serve the public in California during the summer months.

Southern Cities also state that they support the position of the California Municipal Utilities Association (and others) that "the Commission should reinstate cost-based regulation of wholesale prices in the Western region until there is effective competition sufficient to restrain wholesale prices to just and reasonable levels." Southern Cities Motion at 3 n.1. The ISO agrees that the Commission must take much stronger measures to fulfill its statutory obligation under the Federal Power Act to ensure that wholesale electric prices in California are just and reasonable. The Commission's findings of unjust and unreasonable rates and the potential for the exercise of market power in the California wholesale electric markets requires either that the Commission limit suppliers in those markets to cost-based rates or that the Commission condition suppliers' continued enjoyment of market-based rates on the implementation of mitigation measures that will be *effective* to prevent the exercise of market power and ensure that *all* wholesale charges are just and reasonable in all hours of the day. As explained in the ISO's May 7, 2001 comments on the form of price mitigation to be instituted in the Western region[2] and the ISO's forthcoming request for rehearing of the April 26 Order, the measures prescribed in the April 26 Order fail to meet this standard.

[2] Comments of the California Independent System Operator On the Commission's Proposed West-Wide 206 Investigation and Price Mitigation In Spot Markets Throughout the WSCC, Docket Nos. EL00-95-012, *et al.* (May 7, 2001).

Despite the ISO's agreement with Southern Cities on these points, the clarification sought by Southern Cities is neither necessary nor justified. First, there are arrangements currently in place that already provide Southern Cities with assurances that they will receive payment for the costs of providing Energy under the must-offer requirement. As Southern Cities notes, on April 6, 2001, the Commission issued an order in response to a motion filed by a number of California Generators. *California Independent System Operator Corp., et al.,* 95 FERC ¶ 61,024 (2001) (the "April 6 Order"). In the April 6 Order, the Commission held that the ISO must provide third-party suppliers with additional "assurances of a creditworthy buyer for all energy delivered to the loads through the ISO," including real-time Imbalance Energy dispatched by the ISO. April 6 Order, slip op. at 4. The ISO has sought rehearing of the April 6 Order on the grounds that it was issued without adherence to the requirements of Section 206 of the Federal Power Act, that this requirement places assurances of payment to suppliers above the interests of consumers and that it could lead to unnecessary blackouts in California. In the meantime, however, the ISO has implemented procedures and filed conforming Tariff language required by the Commission's order.

In particular, the ISO has made arrangements with the California Department of Water Resources ("DWR") to serve as a counter-party for real-time Imbalance Energy . On April 13, 2001, the ISO issued a notice to all Market Participants describing the terms under which DWR has agreed to "assume financial responsibility for all purchases by the ISO in its ancillary services and Imbalance Energy markets based on bids or other offers determined to be

reasonable" and explaining that "[s]uch determination of reasonableness will be made by DWR on a case by case basis."[3] Southern Cities state that they seek assurances of payment only for the *costs* of producing the Energy which the ISO may dispatch pursuant to the must-offer requirement. Southern Cities Motion at 3 n.1. Southern Cities is free to submit a bid covering its production costs and, if accepted by the ISO, the resulting purchase will be supported by DWR or some other creditworthy party.

Southern Cities express concern that, without additional assurances of payment for Energy provided pursuant to the must-offer requirement, the *pro rata* settlement provisions of the ISO Tariff that apply when the ISO receives less than full payment of ISO market invoices might place Southern Cities and other similarly-situated entities at risk of partial non-payment for Energy provided pursuant to the must-offer requirement. Southern Cities Motion at 5. Southern Cities cites ISO market notices relating to ISO market settlements for January and February 2001 as evidence of this risk. Southern Cities' concern is unjustified. The ISO market settlements for January and February reflect the non-payment by a number of Market Participants, primarily Pacific Gas & Electric Co. and Southern California Edison Co, of excessive power costs during those months. At that time, the ISO had not established the program of financial support provided by DWR for transactions meeting its requirements nor had it committed to declining transactions not so supported. With these recent developments, Southern Cities concerns are without merit.

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[3] This market notice is provided as Attachment A to this Answer.

In addition to the ISO's arrangements with DWR, the ISO submitted Tariff revisions to the Commission on May 11, 2001 relating to credit support for ISO real-time Energy transactions. Those Tariff revisions, submitted to comply with a letter order issued by the Commission on April 26, 2001, provide that "the ISO will only instruct the dispatch of Imbalance Energy to the extent that the purchase of such Imbalance Energy is on behalf of a Scheduling Coordinator that complies with the creditworthiness requirements of [the ISO Tariff] or to the extent an entity . . . has provided assurance of payment on behalf of the Scheduling Coordinator." Because the ISO has sought rehearing of the requirement that the ISO provide additional assurances of payment for real-time Imbalance Energy purchased, those Tariff revisions were submitted under protest. Consistent with its filed Tariff provisions, however, the ISO will not procure or dispatch real-time Energy without a creditworthy party or counter-party to the transaction for so long as the April 6 Order remains in effect.

Southern Cities also claim that they need additional assurances of payment for the Energy made available pursuant to the must-offer requirement in order to avoid violating the "prohibition against gifts of public funds" set forth in Article XVI, Section 6, of the California State Constitution. Southern Cities Motion at 3. The Tariff provisions put in place and the program of financial support provided by DWR eliminates the need to consider the proposition that Energy bids by Southern Cities would be "gifts of public funds". However, even if one were to assume the Tariff provisions and the support offered by DWR were not in place, Southern Cities' claims based on the California State Constitution

are flawed.

First, the claim is made without any discussion or analysis of the applicable state constitutional requirements. On that basis alone, Southern Cities have failed to support their need for the requested clarification. While the Commission is not an appropriate body to be interpreting the provisions of the California Constitution or California state law, a review of applicable precedent shows that, even without additional assurances of payment, providing Energy in the ISO's real-time market would not run afoul of this prohibition. To constitute a gift of public funds contrary to prohibition on such gifts by California public entities, the payment (or in this case, the provision of Energy owned by the California public entity) must be made "without adequate consideration."[4] Provision of Energy in the ISO's real-time Imbalance Energy market is made subject to consideration – the right to recover payment from the Scheduling Coordinators whose Load is served by that Energy. The fact that some Scheduling Coordinators are not immediately paying their ISO market invoices in full does not render such consideration null and void. Southern Cities would still have every opportunity to pursue its rights to receive payment for the Energy provided. There are also reasons to believe that the two main defaulting Scheduling Coordinator will be able to pay their outstanding obligations. Pacific Gas & Electric Co. has expressed the view that, through reorganization, it will satisfy all of its lawful obligations.[5] The State of California is also taking

[4] *See, e.g., California School Emp. Ass'n v. Sunnyvale Elementary School Dist. of Santa Clara County* 111 Cal.Rptr. 433, 36 Cal.App.3d 46 (App. 1 Dist. 1973).

[5] *See, e.g.,* Energy Daily, April 9, 2001.

unprecedented steps to restore the economic vitality of Southern California Edison Company.[6] Thus there is ample consideration for any Energy provided in the ISO's real-time Imbalance Energy market without the need for additional assurances of payment.

Second, putting aside the question of consideration, expenditures of public funds or property which involve a benefit to private persons (such as California electricity consumers) also do not constitute prohibited gifts under the California Constitution if those funds are expended for a *public purpose*.[7] In this instance, the public purpose could not be more clear – reducing the risks to the safety and welfare of the public which would be created or exacerbated by the curtailment of service to California consumers. The provision of available Energy by Southern Cities and other similarly-situated public entities will maintain the continuity of electric service to California consumers and serve this public purpose.

Offering and providing Energy in the ISO's real-time Imbalance Energy market will not result in prohibited "gifts of public funds." As such, there is no justification for the clarification requested by Southern Cities.

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[6] *See, e.g.*, David Lazarus, *Davis Seals Power Deal With Edison to Buy Lines - 10-Year Pact: $2.76 Billion Swap Buys Low-Cost Electricity,* San Francisco Chronicle, April 10, 2001.

[7] *See, e.g.*, *County of Alameda v. Janssen* 16 Cal.2d 276, 106 P.2d 11 (1940).

III. CONCLUSION

The ISO welcomes the commitment of Southern Cities to provide all available Energy to serve the needs of California customers during the current crisis. Mechanisms are already in place which will permit Southern Cities the opportunity to recover the costs of providing such Energy. For the reasons discussed above, however, the Commission should not grant the Southern Cities motion for clarification.

Respectfully submitted,

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Dated: May 25, 2001

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in the above-captioned dockets.

Dated at Washington, DC, on this 25th day of May, 2001.

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