UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Duke Energy Trading and Marketing, LLC) Docket No. EL03-152-000

COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION ON AGREEMENT AND STIPULATION

To: Presiding Administrative Law Judge Carmen A. Cintron

On December 19, 2003, Duke Energy Trading and Marketing, LLC ("Duke") and the Federal Energy Regulatory Commission Trial Staff ("Staff") submitted an Agreement and Stipulation ("December Agreement") to the Commission resolving the issues as raised on June 25, 2003 in *American Electric Power Service Corp*., *et al*., 103 FERC ¶ 61,345 (2003) (the "Gaming Show Cause Order" or the "Order"). Pursuant to Rule 602 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.602 (2003), the California Independent System Operator Corporation ("CAISO") submits these comments on the Agreement.

I. Background

The Gaming Show Cause Order required Duke to show cause why it should not be found to have engaged in False Import, Cutting Non-Firm, Load Shift, Circular Scheduling, Scheduling Counterflows on Out-of-Service Lines, Paper Trading, and Double Selling, as those practices were described in the

Order. In the Agreement, Duke and Staff propose to settle as to Cutting Non-Firm for $41,701, as to Circular Scheduling for $49,535, and as to Double-Selling for $458,737. They propose to settle as to False Import, Scheduling on Out-of-Service Lines, Load Shift, and Paper Trading for no money.

II. Discussion

The CAISO has no objection to the Agreement except with respect to the issue of Double Selling and the Agreement's proposal to absolve Duke from any potential liability for trading practices during the period January 1, 2000 through June 20, 2001.

A. Double Selling

1. The Commission Not Address the Issue of Double Selling of Replacement Reserves in the Context of this Settlement Agreement.

The Agreement states that Duke agrees to pay $458,737 to resolve the issue of Double Selling, and that this payment represents the total revenue received by Duke for the sale of Operating Reserves to the CAISO during those hours which Dr. Fox-Penner, on behalf of the California Parties, identified as involving potential Double-Selling activity by Duke.[1] The Agreement also notes

[1] The CAISO Reports, on which the Commission relied in part in making its findings in the Show Cause Order with respect to many of the Gaming Practices, did not address the issue of Double Selling. Instead, in Amendment No. 51 to the CAISO Tariff, the CAISO proposed rescinding the capacity payments made to suppliers who sold energy from the capacity that they had already committed to provide as Ancillary Services, for the period April 1, 1998 through September 9, 2000. The Commission rejected the CAISO's Ancillary Services rescission proposal in its order issued on November 14, 2003, in the Amendment No. 51 proceeding, 105 FERC ¶ 61,203 (2003). The CAISO has sought rehearing of this order with respect to this issue. *Request for Rehearing of the California Independent System Operator Corp.*, Docket No. ER03-746, filed December 15, 2003.

that Duke received over $1.5 million in revenues during these hours from the sale of Replacement Reserves to the CAISO Market. With respect to these sales of Replacement Reserves, the Agreement states that "Duke believes that the ISO Tariff provides a sufficient basis to conclude that sales of Replacement Reserve were incorrectly identified in the Dr. Fox-Penner Data as Double Selling." Agreement at ¶ 3.9. The Agreement goes on to explain:

> There may be differing views on whether the ISO Tariff required that the amount of capacity sold as Replacement Reserves remain unloaded at all times except when dispatched by the ISO, or required only that the unit providing Replacement Reserves be capable of being at a specified Load point 60 minutes after dispatch ("Replacement Reserves legal issue"). As such, the parties to this Settlement Agreement anticipate that, to the extent that any participant to the proceeding has a position on the Replacement Reserves legal issue, it will make that position known in the Initial and Reply Comments to the Settlement Agreement. The Replacement Reserves legal issue may then be addressed by the Commission in reviewing this Settlement Agreement

Id.

The Agreement states that $1,539,351 is the amount of revenue that Duke received for the sale of Replacement Reserves during the hours identified by Dr. Fox-Penner. The Agreement provides that if the Commission determines that the capacity sold as Replacement Reserves was required to remain unloaded at all times except when dispatched by the CAISO, then Duke will pay the approximately $1.5 million in revenue associated with these transactions.

The Commission should reject this proposed process as an improper attempt to short-circuit the procedure established by the Commission in the Gaming Show Cause Order. In the Gaming Show Cause Order, the Commission stated that the Identified Entities would be required to show cause, through a

trial-type proceeding, that they had not engaged in the Gaming Practices named in that order. The Commission, recognizing that the burden and costs of litigation might outweigh the unjust revenue received as a result of engaging in the Gaming Practices, also encouraged the resolution of these issues through settlement. However, the Agreement's proposed treatment of the issue of Double-Selling of Replacement Reserves is not really a settlement of that issue at all. As the Agreement states, Staff has drawn no conclusion as to whether Duke's interpretation of the CAISO Tariff with respect to Replacement Reserves is correct. Agreement at ¶ 3.9. What the Agreement proposes to do, instead, is to simply shortcut the entire procedural process with respect to this disputed issue, and instead present this issue directly to the Commission under the guise of a settlement. Such a process would be inappropriate, and the Commission should therefore reject the proposed "settlement" of the Double Selling in the Agreement as it relates to the sale of Replacement Reserves.

2. If the Commission Does Consider the Issue of Double Selling of Replacement Reserves in the Context of this Settlement Agreement, then it Should Find that the Sale of Energy from Capacity Committed as Replacement Reserves Does Meet the Definition of Double Selling Set Forth in the Gaming Show Cause Order.

If the Commission nevertheless agrees to consider the issue of Double Selling of Replacement Reserves in the context of this Agreement, it should find that the sale of energy in real-time from capacity that a supplier had sold as Replacement Reserves does, in fact, constitute Double-Selling, consistent with the CAISO Tariff and the Gaming Show Cause Order.

In the Gaming Show Cause Order, the Commission defined Double Selling 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." Gaming Show Cause Order at P. 50. The Commission explained that "the market participant misled the CAISO by selling capacity that it had already committed to reserve as ancillary services, thus making that capacity no longer available in real time if the CAISO were to call upon that resource to provide ancillary services." *Id*. at P. 51.[2] The Commission carved out no exception for Replacement Reserves or any other type of Ancillary Service. Therefore, the sale of energy from capacity committed as Replacement Reserves falls squarely within the definition of Double-Selling set forth in the Gaming Show Cause Order.

The obligation to hold capacity committed as Replacement Reserve in reserve and unloaded prior to CAISO dispatch is also embodied in the terms CAISO Tariff. Section 2.5.21 of the CAISO Tariff provides that Ancillary Service Schedules "represent binding commitments made in the markets between the ISO and the Scheduling Coordinator concerned." The CAISO Scheduling Protocol provides that the CAISO will make payment only for capacity that is "made available." CAISO Scheduling Protocol, Sections 9.6.2., 9.7.2, 9.8.2. Moreover, the obligation of Scheduling Coordinators to hold capacity sold as Ancillary Services in reserve was affirmed by the Commission in its order on

[2] The Commission also noted that the practice of Double Selling violated Section 2.5.22.11 of the CAISO 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*.

Amendment No. 13 to the CAISO Tariff. *California Independent System Operator Corp*., 86 FERC ¶ 61,122 (1999) ("Amendment No. 13 Order"). In that order, the Commission explained that:

> Under the ISO Tariff, unscheduled generation that is delivered to the ISO is compensated at the market clearing price for imbalances. When the imbalance energy involves the output of an Ancillary Service provider, the generator is paid twice (the Ancillary Service capacity charge and the energy imbalance energy charge) *and the ISO is exposed to reliability risks because it expected the generating resources to be held in reserve*. According to the ISO, 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.

Id. at 61,418 (emphasis added).

In accepting Tariff Amendment No. 13, the Commission stated:

> We believe that the ISO's proposal to withhold both payments when an Ancillary Service provider fails to honor its commitment to remain unloaded until directed by the ISO is reasonable. Withholding 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.

Neither the CAISO Tariff, nor the Commission's orders, carves out any exception to the obligation to keep capacity unloaded with respect to Replacement Reserves. As with all other types of Ancillary Services, the CAISO has full authority and discretion in determining how the capacity that the CAISO has purchased shall be dispatched. As the Commission stated in the Amendment No. 13 Order, the failure of suppliers to hold the capacity committed as Ancillary Services in reserve exposes the CAISO to reliability risks because

the CAISO expects that this capacity will be held in reserve. This is no less true for capacity committed as Replacement Reserve. For this reason, Duke's argument that suppliers were free to sell energy from capacity committed as Replacement Reserves is completely unfounded. The Commission should therefore reject Duke's argument and find that the sale of energy from Replacement Reserve capacity meets the definition of Double Selling set forth in the Gaming Show Cause Order.

B. The Commission Should Not Accept the Agreement's Proposal to Absolve Duke from all Liability Connected with its Trading Practices for the Period Under Investigation

The CAISO also objects to Paragraph 4.5 of the Agreement, which provides that the effectiveness of the Agreement is conditioned on:

> The Commission assuring that at no time and under no circumstances shall Duke Energy be subject to further scrutiny, investigation or proceedings of any kind for its trading activities in the State of California during the period January 1, 2000 through June 20, 2001, inclusive.

Agreement at ¶ 4.5.

This purported condition, in which Staff did not join, should be expressly rejected by the Commission in any order approving the agreement. Duke has suggested no rationale for why this patently overbroad release would be in the public interest, and there clearly is none. Settlement with respect to the specific transactions that are the subject of the Gaming Order with respect to Duke is all that Duke has offered and all that the Commission should approve. Moreover, it would be inappropriate to discharge Duke from any claims made in proceedings

other than the Show Cause proceeding given that the issue of Double Selling is still pending before the Commission in the Amendment 51 Proceeding, in the form of the rehearing of the Amendment 51 Order. The Commission should make clear in any order that neither the Agreement, the Commission's order, nor payment of the amount called for by the Agreement, will affect Duke's potential liability under any other proceeding now ongoing, or prevent the institution of future Show Cause or other proceedings against Duke based on time periods, practices or transactions different from those made relevant to Duke in the Gaming Order.[3]

[3] As noted above, the CAISO has sought rehearing of the Commission's denial, in the Amendment No. 51 Order, of the CAISO's proposed rescission of payments for unavailable Ancillary Services. If the Commission permits rehearing on this issue and allows the CAISO to pursue the rescission of Ancillary Services payments in that proceeding, then the CAISO would have no objection to Duke offsetting any amounts that it paid to satisfy the claims of Double

III. Conclusion

For the foregoing reasons, the CAISO objects to the proposed Agreement between Staff and Duke with respect to the issue of Double Selling of Replacement Reserves, as well as Paragraph 4.5, and respectfully requests that the Commission reject these portions of the Agreement.

Respectfully submitted,

/s/ Michael Kunselman

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Dated: January 20, 2004

Selling in the Show Cause proceeding against the amount determined to be owed by Duke in the Amendment 51 proceeding.

CERTIFICATE OF SERVICE

In accordance with the order issued by the Presiding Administrative Law Judge I hereby certify that I have this day served the foregoing document by posting an electronic copy on the Listserv for this proceeding, as maintained by the Commission.

Dated at Washington, DC, on this 20th day of January, 2004.

/s/ Michael Kunselman
Michael Kunselman