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May 6, 2003

The Honorable Magalie Roman Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

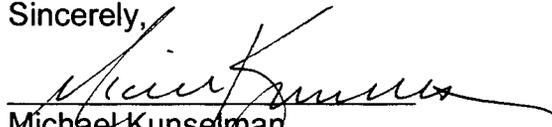
Re: *San Diego Gas & Electric Co., et al.*
Docket Nos. EL00-95-045, et al.

Dear Secretary Salas:

Enclosed for filing are one original and fourteen copies of the Response to Generators' Expedited Motion on Average vs. Incremental Heat Rates in the Gas Cost Allowance of the California Independent System Operator Corporation ("ISO") submitted in the above-captioned proceeding.

Also enclosed are two extra copies of the filing 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.

Sincerely,


Michael Kunselman
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Counsel for the California
Independent System Operator Corporation

Enclosures

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

San Diego Gas & Electric Company,)	
Complainant,)	
)	
v.)	Docket No. EL00-95-045
)	
Sellers of Energy and Ancillary Services)	
Into Markets Operated by the California)	
Independent System Operator and the)	
California Power Exchange,)	
Respondents.)	
)	
Investigation of Practices of the California)	
Independent System Operator and the)	Docket No. EL00-98-042
California Power Exchange)	

**RESPONSE TO GENERATORS' EXPEDITED MOTION ON AVERAGE VS.
INCREMENTAL HEAT RATES IN THE GAS COST ALLOWANCE**

The California Independent System Operator Corporation ("ISO") submits this response to the California Generators' ("Generators") Expedited Request for Clarification, filed on May 1, 2003. The ISO addresses only the first of the two clarifications requested by the Generators, concerning the issue of whether incremental or average heat rates are to be used for the gas cost allowance. The ISO submits that the Commission should deny that request.

The history presented by the Generators in their request is revisionist in the extreme. The Generators state, as if it were irrefutable fact, that the

Commission in the March 26 Order¹ provided that generators could recover minimum load fuel costs in the gas cost allowance introduced for the first time in that order. Generators' Request at 2. They also present as fact that the Commission in the April 22 Order² affirmed this approach. *Id.* After presenting this revisionist view of the "facts," the Generators then ask the Commission to "clarify" that a particular statement in the April 22 Order was not intended to change these "facts."

The Generators' have their "facts" wrong. The Commission did not, in either the March 26 Order or the April 22 Order, indicate an intent that the Generators recover their minimum load fuel costs through the gas cost allowance. Generators claim that in paragraphs 14 and 61-62 of the March 26 Order the Commission determined that generators should recover "all" fuel costs beyond the proxy gas price in the MMCP formula, and that in the April 22 Order the Commission "affirmed" that position by stating that the fuel cost allowance "is meant to reimburse generators for *any* unrecovered cost of gas." Generators' Request at 2 (emphasis added by Generators). In the cited paragraphs of the March 26 Order, the Commission was not suggesting that a different *heat rate* should be used in the gas cost allowance than the one used in the MMCP calculation; rather, as is clear from the first sentence in paragraph 61, it was making clear that a different *price* for gas would be used. After all, the very purpose of the gas cost allowance is to protect generators who might have paid a

¹ Order on Proposed Findings on Refund Liability, *San Diego Gas & Elec.*, 102 FERC ¶ 61,317 (2003) ("March 26 Order").

² Order Clarifying Fuel Cost Allowance, *San Diego Gas & Elec.*, 103 FERC ¶ 61,078 (2003) ("April 22 Order").

price for gas based on the faulty spot price indexes. The fuel cost allowance was necessary, in the Commission's view, only because the Commission was now jettisoning those indexes in calculating the MMCPs. There is no indication in the March 26 Order that the Commission considered it necessary to allow generators to use a heat rate in calculating the gas cost allowance that differed from the one to be used in calculating the MMCP. The MMCP is to be calculated based on incremental heat rates, March 26 Order at P 13, which do not include minimum load fuel costs, *id.* at P 14; the same is true of the gas cost allowance. Once one understands what the Commission did in the March 26 Order, the reference in the April 22 Order to the generators' recovering in the gas cost allowance "any unrecovered cost of gas" left after the calculation of the MMCP is clearly, and correctly, understood as a reference to the costs resulting from paying a different *price* for gas from the price assumed in the calculation of the MMCP.

Thus, the real "facts" are that the Commission in the March 26 Order indicated that incremental heat rates were to be used in both the calculation of the MMCP and in the calculation of the gas cost allowance, and in the April 22 Order it reaffirmed that point. The statement in the April 22 Order that the Generators now seek to characterize as inadvertent and in need of clarification was in reality *central* to the Commission's reaffirmation that incremental heat rates were to be used in the gas cost allowance. The statement on which the Generators now focus is that "use of incremental heat rates in the determination of the additional fuel cost allowance would be consistent with the calculation of the MMCP." April 22 Order at P 18. That statement was not just a throw-away

line on which the Commission did not focus, as the Generators now would present it. Quite the contrary, it was the Commission's *direct response to an issue that had been squarely presented to it in pleadings*. The California Parties, in their April 2 request for clarification of various aspects of the gas cost allowance, had noted in passing that the Commission in the March 26 Order had intended the gas cost allowance to be calculated using incremental heat rates.³ Another party, the Los Angeles Department of Water and Power ("LADWP"), responded to the California Parties' filing by urging the Commission to reject use of incremental heat rates and instead allow use of average heat rates in calculating the gas cost allowance.⁴ After describing these conflicting positions, see April 22 Order at P 18, the Commission made the statement now focused on by the California Generators. *Id.* The statement was hardly inadvertent, as Generators now suggest; the statement was the Commission's direct resolution of the dispute concerning the March 26 Order that had been framed for it by the pleadings. In response to LADWP's teeing up of the issue, the Commission was *reconfirming that incremental heat rates were to be used and giving a rationale for that choice, namely, consistency with the MMCP calculation.*

The Generators suggest that there is no logical connection between using the incremental heat rate in the MMCP calculation and using it in the calculation of the gas cost allowance. See Generators' Request at 2. In fact, there is more than a logical connection – the heat rate for determining the MMCP and the heat

³ California Parties' Motion for Expedited Clarification Relating to Additional Fuel Cost Allowance and Request for Shortened Response Period, filed on April 2, 2003, at 6-7.

rate for determining the gas cost allowance are *one and the same*. The Commission determined that the MMCP should mimic a competitive market and that incremental heat rates do that. Its determination that generators should receive some protection (over and above the ultimate cost-based rates they could obtain, if necessary, at the end of the refund proceeding)⁵ for having possibly bought gas based on the faulty spot price indexes addresses the *price* a generator paid for gas, *not how much* gas it will be assumed to have used for purposes of mitigation. The gas cost allowance is just a modification of *one aspect* of the MMCP formula, *i.e.*, the price of gas, as that formula gets applied to each individual seller. In all other respects, including *the use of incremental heat rates*, that formula stays the same.⁶ The Generators' pleading is not, in fact, a request for clarification of the April 22 Order. It is, rather, a request for rehearing of the March 26 Order. In the March 26 Order, the Commission intended that incremental heat rates be used in the gas cost calculation. In the April 22 Order, it clarified that intent and explained a rationale for it. The Generators are several days late in requesting rehearing of the March 26 Order on this point. This is just an attempt by the California Generators to take a "third bite of the apple" as it

⁴ Answer of the City of Los Angeles Department of Water and Power to the California Parties' Motion for Expedited Clarification Relating to Additional Fuel Cost Allowance, filed April 10, 2003, at 6.

⁵ The ISO sought rehearing of the Commission's grant of the gas cost allowance, arguing that it is unnecessary, given the opportunity for generators to obtain cost-based rates, overly generous in that a generator apparently can get it even if it did not buy gas based on the faulty spot price indexes, and inequitable to buyers in that it visits on them – without justification – the full effect of any defects in those spot price indexes. See Request for Rehearing and/or Clarification of the California Independent System Operator Corporation, filed April 25, 2003, at 33-36.

⁶ The Generators constantly refer to the gas cost allowance as some sort of "uplift," akin to the emissions cost allowance to which they are entitled as an offset to their refund obligation. The gas cost allowance is not really an uplift like the emissions cost allowance; rather, it is *only* a

relates to the heat rate question. It's time they understood that the Commission has decided this issue. The Generators' Request should be denied.

Respectfully submitted,

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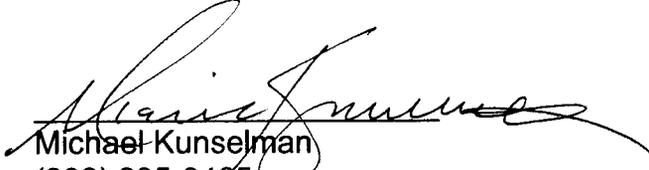
Dated: May 6, 2003

modification to the gas price component of the MMPC formula as that formula gets *applied* to each seller.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the restricted service list compiled by the Presiding Administrative Law Judge in this proceeding.

Dated at Washington, DC, this 6th day of May, 2003.


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