UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

San Diego Gas & Electric Company, Complainant,	)	
	)	**Docket No. EL00-95-087**
v.	)	
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 California Power Exchange	)	**Docket No. EL00-98-074**

RESPONSE OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO INDICATED GENERATORS' ANSWER TO THE ISO'S MOTION FOR CLARIFICATION OF THE COMMISSION'S MAY 12 ORDER

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213 (2001), the California Independent System Operator Corporation ("ISO") [1] hereby submits its response to the Indicated Generators' Answer to the ISO's Motion for Clarification of the Commission's May 12 Order. Specifically, this response addresses arguments raised by the Generators with respect to the Commission's ruling on the treatment of CERS transactions in its May 12, 2004 Order on Requests for Rehearing and Clarification in this proceeding.[2] For the reasons set forth herein, the

[1] Capitalized terms not otherwise defined herein are used in the sense given in the Master Definitions Supplement, Appendix A to the ISO Tariff.
[2] 107 FERC ¶ 61,159 (2004) ("May 12 Order").

Commission should reject the Generators' answer and accept the ISO's motion for clarification of the May 12 Order.

I. BACKGROUND

Although this issue dates back to the Commission's original March 26, 2003 order in this proceeding, the genesis of the current controversy is the Commission's October 16, 2003 Order on Rehearing.[3] In that order, the Commission stated that it had already ruled that CERS functioned as the Scheduling Coordinator for the IOU's net-short load and must, therefore, abide by the requirements of the ISO Tariff and the Scheduling Coordinator Agreement with respect to that net short load. The Commission ruled, therefore, that the ISO must correct its accounting in order to reflect CERS "as the scheduling coordinator for the IOU's net-short load." *Id*. at P 113.

In response, the ISO requested clarification that it had already complied with the Commission's requirement that CERS be treated as the Scheduling Coordinator for the net-short load of the IOUs. The ISO explained that it had done so by invoicing CERS directly for the energy used to serve the net-short load of the IOUs. The California Parties also filed a request for clarification of this ruling, in which they explained that CERS activity during the Refund Period[4] fell into three categories: (1) bilateral purchases by CERS from sellers that CERS scheduled on a day-ahead basis; (2) bilateral purchases by CERS from sellers made at the instruction of the ISO in order to provide Imbalance Energy needed by the ISO in real time in order to maintain grid reliability; and (3) purchases by the ISO from sellers in real time in order to serve the net

[3] 105 FERC ¶ 61,066 at PP 110-113 (2003) ("October 16 Order").

[4] The Refund Period is October 2, 2000 through June 20, 2001.

short load of the IOUs, for which CERS agreed to provide credit backing. The California Parties stated that it would be inappropriate to treat CERS as a Scheduling Coordinator for *all* Imbalance Energy that CERS supplied to the ISO, but that CERS only would be responsible for that portion of the imbalance energy attributable to the IOUs.

The Generators answered these pleadings by contending that it would be improper for the ISO to treat the energy provided by CERS as a sale to the ISO, and that the ISO was seeking to provide CERS with special status by treating CERS energy as a sale to the ISO that is not subject to mitigation. In their last pleading filed on this issue prior to the May 12 Order, the Generators offered three alternative approaches to resolve this issue consistent with their position. These alternatives were set forth in an affidavit provided by their witness, Mr. Jeffrey Tranen. The first approach would have required the ISO to recategorize all of CERS' Imbalance Energy sales to the ISO as energy prescheduled by CERS prior to the close of the hour-ahead market in order to serve the needs of the IOUs' net short load, while under the third approach, the ISO would continue to treat all of the CERS sales as Imbalance Energy, but mitigate the price of those sales down to the level of the Commission's mitigated market clearing prices (MMCPs).[5]

In the May 12 Order, the Commission concluded that the cost of Imbalance Energy should be borne by the parties responsible for the imbalance, but that the ISO had treated CERS energy as an unmitigated sale to the ISO, thus seeking to pass on the cost of bilateral transactions or the unmitigated price of Imbalance Energy. May 12 Order at P 61. The Commission stated that this outcome was unreasonable. In order

to correct this situation, the Commission ordered the ISO to proceed with the refund process using Tranen's third approach, which would require the ISO to leave its settlements records as-is, to treat all CERS energy as Imbalance Energy, but to mitigate all of the CERS energy like any other imbalance sale made to the ISO during the Refund Period. Additionally, in order to correct the ISO's accounting so only those who received the benefit of Imbalance Energy pay for it, the Commission directed the ISO, after the refund proceeding is complete, to "surcharge the appropriate customers for any amounts that were inappropriately accounted for in treating and thus mitigating all CERS energy as Imbalance Energy." *Id*. at P 63. Specifically, the Commission stated that only bilateral purchases by CERS from sellers made at the instruction of the ISO in order to provide Imbalance Energy needed by the ISO in real time to maintain grid reliability should be recorded as Imbalance Energy, and that the ISO should remove the mischaracterization as Imbalance Energy of both: (1) bilateral purchases by CERS from sellers that CERS scheduled on a day-ahead basis with the ISO and, (2) purchases by the ISO from sellers in real time in order to serve the net short load of the IOUs. *Id*. Essentially, the Commission concluded that although the first and third categories of CERS transactions, as described by the California Parties, should not be treated as Imbalance Energy, the second category of CERS energy, bilateral purchases by CERS from sellers made at the instruction of the ISO in order to provide Imbalance Energy needed by the ISO in real time in order to maintain grid reliability, is properly accounted for as Imbalance Energy.

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[5] California Generators' Answer to the California Parties and California ISO's Reply Regarding Clarification, or in the Alternative, Rehearing, Responsive Affidavit of Jeffrey Tranen Affidavit attached to the Generators' December 30 Pleading ("Tranen Affidavit"), at PP 6-7.

In response to the Commission's ruling on CERS, the ISO explained that it is currently in the process of completing a self-audit of its records of Imbalance Energy transactions made during the period at issue (*i.e*., January through June of 2001) in order to identify what, if any, transactions in those records fall under the two categories that the Commission directed the ISO to include in the surcharge. The ISO requested clarification that if there are no such transactions recorded as Imbalance Energy, then there is no need to develop a surcharge as directed by the Commission.

II. RESPONSE

In response to the ISO's straightforward request for clarification of the Commission's surcharge ruling, the Generators, in the guise of an answer to the ISO's request, propose an entirely new treatment of CERS transactions. Instead of developing a surcharge that includes the categories identified by the Commission, the Generators suggest that the ISO should treat *any* CERS energy, to the extent there existed IOU net short load on an hourly basis, as a bilateral purchase subject to surcharge. Generators at 13. This proposal is inconsistent not only with the May 12 Order, but remarkably, with the Generators' own recommendation for treating CERS energy which was ultimately adopted by the Commission.

In his affidavit describing three possible alternatives for treating CERS energy, Mr. Tranen stated that each of these alternative approaches "correctly treats CERS energy under a different set of assumptions, depending on how much of the CERS energy was provided after the close of the hour-ahead market."[6] Because he did not have access to data as to how much of the CERS energy was actually provided before

or after the close of the hour-ahead market, Mr. Tranen stated that he had used the first and third alternatives as extremes in order to calculate the maximum amount of "error" that would result from using the third approach.[7] Mr. Tranen arrived at a figure of $22 million, which, he testified, represented the maximum amount that would be mis-allocated to non-IOU Market Participants, assuming that none of the CERS energy was provided after the close of the hour-ahead market. If, in fact, all of the CERS energy was provided after the close of the hour-ahead market, however, Mr. Tranen stated that the third approach would be the correct method for treating CERS as the Scheduling Coordinator for IOU's net short position, and that no mis-allocation would result.[8]

As noted above, the Commission adopted this third approach in the May 12 Order, even though, according to the Commission, it might result in a temporary improper accounting of up to approximately $22 million. In order to address this possible improper accounting, the Commission required the ISO to develop the surcharge methodology to insure that only Imbalance Energy provided by CERS was treated and accounted for as such. Thus, it is clear that the surcharge ordered by the Commission in the May 12 Order was based directly on Mr. Tranen's statement that adopting his third alternative approach could possibly result in an improper allocation of up to $22 million, depending on the amount of CERS energy that was provided to the ISO by CERS after the close of the hour-ahead market. The ISO's request for clarification merely asked the Commission to recognize, as Mr. Tranen did, that it was possible that none of the energy provided by CERS, and recorded by the ISO as Imbalance Energy, was provided before the close of the hour-ahead market. If so, then

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6 Tranen Affidavit at P 7.

7 *Id*.

according to Mr. Tranen, no improper accounting would have occurred, and thus, there would be no need for a surcharge. The ISO asked simply that the Commission confirm that which is implicit in its decision.

Now, apparently unsatisfied with the ramifications of their own proposal, the Generators not only want to have their cake and eat it too, but to come back for a second slice. Ignoring the distinction drawn by the Commission and their own witness, the Generators suggest that the ISO should not only subject to surcharge the CERS energy that the Commission, as well as their own witness, stated should not be accounted for as Imbalance Energy, but *all* energy provided by CERS as Imbalance Energy, to the extent there existed IOU net short load on an hourly basis. This proposal obliterates the Commission's explicit finding that the ISO should continue to treat as Imbalance Energy the energy provided by CERS in real time in order to maintain grid reliability, and to subject to surcharge only: (1) bilateral purchases by CERS from sellers that CERS scheduled on a day-ahead basis with the ISO, and (2) purchased by the ISO from sellers in real time in order to serve the net short load of the IOUs. It also flies in the face of Mr. Tranen's sworn statement that if all CERS energy was provided after the close of the hour-ahead market, then no "improper allocation" would occur, and, naturally, no surcharge would be necessary.

In support of their argument, the Generators claim that the May 12 Order approved mitigation of CERS energy only as a "temporary accounting of approximately $22 million" to allow the refund proceeding to move forward, but that such temporary mitigation, along with the surcharge, was not intended to "negate correct characterization of the remaining portion of the reported $270 million that is associated

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[8] *Id*. at P 9.

with non-mitigated bilateral transactions to serve IOU net-short load." Generators at 9. Instead, the Generators claim that the ISO should be required to adopt a methodology that is "true to the letter and spirit of the May 12 Order," which, according to the Generators, recognizes that the "majority of CERS transactions are being mitigated only as a matter of temporary administrative efficiency and are for other purposes to be treated as nonmitigatable bilateral purchases to serve IOU net-short load." *Id*. at 9-10.

The problem with the Generators' argument is that this recitation of the so-called "letter and spirit" of the May 12 Order is entirely at odds with the actual language of the May 12 Order, not to mention their own witness' sworn affidavit. The Commission, in the May 12 Order, did not in any way suggest that the "majority of CERS transactions are being mitigated only as a matter of temporary administrative efficiency." Quite the opposite. The Commission stated explicitly that the mitigation of CERS energy could result in an improper accounting of up to $22 million, and that it was this $22 million that would be the subject of the surcharge. [9] Again, this $22 million is the same $22 million that Mr. Tranen identified as the *maximum* amount of improper allocation that could occur as a result of adopting his third alternative. Given this statement, and the Commission's clear language in the May 12 Order, for the Generators to now suggest that the majority of CERS transactions are being mitigated only as a matter of "temporary administrative efficiency," and that the ISO's surcharge should include far more than those transactions identified by Mr. Tranen and the Commission as possibly mischaracterized, is misleading in the extreme, and should be rejected.

[9] *See* May 12 Order at PP 62-63 ("We recognize that [treating and mitigating all CERS Energy as Imbalance Energy] may result in a temporary improper accounting of approximately $22 million . . . .[t]o address the improper accounting and ensure that only those who received the benefit of the Imbalance

The Generators also argue that the ISO should not be permitted to rely on its Imbalance Energy records in determining whether those records include CERS transactions subject to surcharge, because, according to the Generators, the Commission has already found that those records improperly accounted for those transactions. Generators at 10-11. Again, Generators read into the May 12 Order findings that do not exist. The Commission did not conclude that the ISO's records mischaracterized anything. Instead, the Commission concluded that the ISO may have improperly *treated* up to $22 million in CERS energy as Imbalance Energy. May 12 Order at PP 62-63. Despite the Generators continuing efforts to smear the ISO's record keeping, the issue here is not, and has never been, one of the underlying accuracy of the ISO's records. The issue is whether the ISO was correct in its *decision* as to how to properly account for and settle CERS energy. In any event, the ISO is not proposing to rely on its "characterization" of CERS transactions, but as stated in its request for clarification, intends to review its Imbalance Energy records in order to specifically identify whether any of those transactions meet the criteria identified by the Commission for inclusion in the surcharge.

Given that the Generators' proposal in their answer to the ISO's request for clarification is entirely inconsistent with both the clear language of the May 12 Order, as well as the Generators' witnesses own sworn statement, the Commission must reject the Generators' "answer," and with it their proposal that the ISO subject to surcharge all CERS energy to the extent there existed IOU net short load on an hourly basis. Moreover, the Commission should accept the ISO's request for clarification that if its

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Energy will pay for it, the CAISO is directed to develop a surcharge for imposition after its refund process is complete.").

audit of its Imbalance Energy records do not reveal any transactions that fit into the two specific categories identified by the Commission as subject to surcharge, that there is no need for the ISO to implement a surcharge. As demonstrated above, this result is consistent not only with the May 12 Order, but also with the Generators' own testimony.

III. CONCLUSION

Wherefore, for the reasons set forth above the Commission should reject the Generators' answer and grant the ISO's motion for clarification of the May 12 Order.

Respectfully submitted,

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Dated: July 14, 2004

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 these proceedings.

Dated at Folsom, CA, this 14th day of July, 2004.

/s/ Gene L. Waas
Gene L. Waas