

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

California Power Exchange Corporation

Docket No. EL03-223-000

ORDER GRANTING PETITION FOR
DECLARATORY ORDER

(Issued October 23, 2003)

1. On August 21, 2003, the California Power Exchange Corporation (CalPX) filed a petition for declaratory order (Petition) requesting the Commission's approval of a proposed agreement between itself and American Home Assurance Company (AHA). CalPX states that, if approved, the agreement will resolve its claim arising from a market participant's failure to pay its trading obligations in CalPX's Core Market. This order approves the agreement since the resolution of CalPX's claim will expedite the resolution of issues relating to its Settlement Clearing Account.

Background

2. On August 14, 2000, AHA, as the surety, issued a \$20 million performance bond to CalPX. The stated purpose of the bond was to provide all of CalPX's market participants with an additional level of security for trading in Core Market. Under the terms of the performance bond, CalPX could demand payment under the bond in the event that a market participant failed to honor its obligations. The bond also provides that defaulting market participants could be held separately liable by AHA for any draws that CalPX made on the bond.

3. In early 2001, CalPX made demands for payment under the bond in response to the failure of Southern California Edison Company (SCE) and Pacific Gas and Electric Company (PG&E) to pay for trades in the Core Market. While SCE has since paid its obligations and CalPX has subsequently withdrawn its claim against the bond with regard to SCE's nonpayment, CalPX continues to pursue its claim for \$20 million under the bond for PG&E's nonpayment. However, stemming from a dispute over certain

provisions in the bond, AHA has not tendered payment. As a result, AHA and CalPX have arbitrated and litigated this matter for the past one and one-half years.¹

CalPX's Petition

4. In an attempt to avoid the uncertainties and expenses associated with litigation, CalPX and AHA propose an agreement to resolve a dispute over the terms of the bond. Under the terms of the agreement, AHA would pay \$7.5 million on the bond to CalPX (which would be deposited into the Settlement Clearing Account), and an additional \$300,000 towards CalPX's legal expenses for pursuing its claim (which would be deposited into CalPX's Operating Account). In exchange, CalPX would assign \$7.5 million to AHA as a portion of CalPX's claims asserted in the PG&E bankruptcy proceeding (to the extent CalPX has any such claims). In the event that AHA were to recover less than \$7.5 million on the assigned claim, CalPX and AHA may bring a motion before the Commission for authorization to pay AHA from the Settlement Clearing Account for any unrecovered amount on the assigned claim.²

5. CalPX states that, since the bond is a Commission-jurisdictional asset, CalPX seeks Commission approval to enter into the proposed agreement with AHA. CalPX believes that it is in the best interest of its participants and itself to accept the agreement for several reasons, including the fact that the agreement will bring an end to the costly expenses incurred in pursuing its claim against AHA. CalPX states that, by settling now, CalPX can cease incurring costs to recover the bond and immediately realize \$7.5 million in the Settlement Clearing Account, as well as the \$300,000 that AHA will pay towards CalPX's legal expenses.

6. CalPX states that if the Commission approves the agreement, the bond would be exonerated³ and CalPX would transfer and assign to AHA any and all rights it may have to seek reimbursement for attorneys' fees and costs related to the arbitration against

¹The dispute arises from AHA's allegation that CalPX should have downgraded PG&E's credit status for the Core Market prior to January 2001. AHA contends that under the Bond Letter Agreement, it has a right of indemnification from CalPX to the extent AHA incurs a loss on the Bond as a result of CalPX's alleged failure to strictly enforce the credit policies under its Tariff.

²AHA, however, would only be paid for such an unrecovered amount after all claims from market participants are fully satisfied in accordance with Commission orders.

³Section 3.4 of the agreement states that "upon the effectiveness of this Settlement Agreement the Bond shall be deemed exonerated and no further demands or claims shall be made upon it by CalPX or any affiliated entities...."

PG&E or SCE. CalPX also points out that the agreement with AHA is limited to the recovery under the bond and the specific matters addressed in the agreement. CalPX states that the agreement is not intended to, nor should it or any order based on its Petition affect, in any manner, nor have any res judicata or collateral estoppel effect on, any claim or proceeding against any party other than AHA.

7. Finally, CalPX petitions for waiver of the filing fee associated with its Petition, claiming that good cause exists for the Commission to waive this fee. CalPX reminds the Commission that it has not operated its exchange services since January 2001 and states that the payment of the filing fee would cause financial distress since it is trying to conserve its limited resources while it winds down its business affairs.

Notice of Petition and Responsive Pleadings

8. Notice of the Petition was published in the Federal Register, 68 Fed. Reg. 52,760 (2003), with motions to intervene and protests due on or before September 22, 2003. California Electricity Oversight Board (CEOB), Pacific Gas & Electric Co. (PG&E), and Powerex Corp. filed timely motions to intervene, with CEOB filing comments and PG&E filing comments and a protest. Additionally, CalPX filed an answer to PG&E's protest, and PG&E filed an answer in response to CalPX's answer.

Comments and Protest

9. In its comments, CEOB only contends that any claims that CalPX may assert in the PG&E bankruptcy proceeding should not be compromised by the agreement.

10. PG&E, however, claims that the proposed agreement is based on the mistaken notion that PG&E will default on its payment obligations. PG&E notes that proceedings between CalPX and AHA commenced over one and a half years ago, when the market dysfunctions of the California markets forced PG&E to file for bankruptcy protection. At that time, there may have been doubts about PG&E's ability to pay. However, PG&E states that there is no longer a concern that PG&E will not be able to satisfy its obligations to its creditors, and therefore, the proposed agreement is not necessary.

11. PG&E also states that the structure of the proposed agreement improperly waives the surety's obligations for claims relating to all other parties. PG&E also believes that approval of the proposed agreement is premature given that the trades made in the CalPX markets are not yet fully resolved and the payment obligations of PG&E and other market participants are not final. PG&E argues that the retention of collateral, surety bonds and other security instruments are necessary until payment obligations of PG&E and other market participants are fully resolved. Specifically, PG&E notes that Sections 2.5 and 3.4 of the proposed agreement release AHA from any further claims against the bond.

12. PG&E claims that this result jeopardizes the rights of PG&E and other market participants in the event that a CalPX market participant defaults on its obligations. Specifically, PG&E states that the settlement of all claims with respect to the bond between AHA and CalPX through the proposed agreement jeopardizes the rights of PG&E and other market participants in the event that a CalPX market participant defaults. Further, PG&E states that if a market participant defaults on payments or is unable to satisfy the amount it owes to the CalPX, the CalPX will have no recourse from AHA to make a claim on the bond on behalf of those other market participants, if the proposed agreement is approved.

13. PG&E argues that such a result should not be condoned, given current market conditions, and the credit risk that some of the market participants may pose. In addition, PG&E notes that the Commission affirmed the importance of retaining collateral and other instruments, in the bankruptcy proceeding. PG&E states that the same reasons that the Commission continues to require the CalPX to retain collateral and other security instruments are equally applicable here. Therefore, PG&E states that the Commission should require the CalPX to continue to retain its surety obligations with AHA. PG&E also argues that the proposed agreement does not provide a just and reasonable result, given that it compromises the rights of market participants, for no good reason, based on a misapprehension of the facts. For these reasons, PG&E requests that the Commission assert jurisdiction over the bond, and reject the proposed agreement. In the alternative, if the proposed agreement is approved, PG&E maintains that any consideration received by CalPX should directly reduce PG&E's total obligations to CalPX and/or its market participants on a dollar for dollar basis, to ensure that PG&E will not be subject to double liability.

14. Finally, PG&E states that Section 3.3 of the proposed agreement improperly seeks to impose recovery from PG&E and SCE of additional attorney fees and costs related to the arbitration.⁴ PG&E asserts that the Commission has previously held that, in any rate case, costs should be allocated, where possible, to customers based on customer benefits and cost incurrence. PG&E also reminds the Commission that CalPX is currently recovering litigation costs through wind-up charges. PG&E contends that the expenses that have been incurred to arbitrate the bond only benefit those entities represented by the Participants Committee and should not be allocated to PG&E and SCE. PG&E further states that, if for any reason the Commission believes that the costs of arbitrating the

⁴Section 3.3 reads, in pertinent part: "CalPX hereby transfers and assigns to American Home any and all rights and or interest CalPX may have against SCE or PG&E under the SCE or PG&E Participation Agreement and under any other contract, order, statute, or common law, to the extent CalPX is entitled to seek or obtain reimbursement for attorneys' fees and costs incurred by CalPX which arise from, are based upon, are connected with, or related to, the Arbitration, SCE's participation in the Arbitration."

bond and associated legal fees has had some benefit to PG&E and SCE, then at the very least, these costs should be shared by all market participants, and not limited to just PG&E and SCE.

Discussion

15. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2003), the timely unopposed motions to intervene serve to make these entities parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2003), prohibits answers to protests and other answers. We are not persuaded to waive this prohibition, and the answers of CalPX and PG&E are rejected.

16. Upon review of CalPX's Petition and the proposed agreement, the Commission approves the agreement between CalPX and AHA.⁵ The Commission finds the agreement has the potential to expedite the resolution of issues relating to the Settlement Clearing Account and, in turn, disbursements to sellers and buyers in the California Refund Proceeding.⁶

17. Responding to PG&E's protest, the Commission does not find that the agreement is unreasonable simply because CalPX will agree not to make any further claims on the bond. CalPX has determined that the benefits of immediately realizing a \$7.5 million claim on the bond outweigh the possibility that it might make a \$20 million claim on the bond sometime in the future. In finding this decision to be reasonable, the Commission will not second-guess CalPX's decision to secure the \$7.5 million for the benefit of the Settlement Clearing Account and forgo the possibility of a larger, but speculative, claim in the future. Furthermore, in light of the extended litigation that CalPX and AHA have already engaged in, it is questionable whether CalPX would ever be able to successfully make a claim for the full \$20 million face value of the bond.

18. The Commission also disagrees with PG&E's argument that any consideration received by CalPX from AHA should directly reduce PG&E's total obligation to CalPX and its market participants on a dollar for dollar basis; PG&E does not adequately explain how it would be subject to double liability under these circumstances. Since CalPX will forgo pursuing any further claim against PG&E for the \$7.5 million that it will receive from AHA, PG&E would only be potentially liable to AHA for the \$7.5 million as a

⁵The Commission considers the proposed agreement to be a contract which affects or relates to jurisdictional rates, charges, classifications, and services. See 16 U.S.C. § 824d(c) (2000).

⁶See Docket Nos. EL00-95-045 and EL00-98-042.

result of CalPX assigning this claim to AHA. Moreover, if it is ultimately determined that PG&E is a net creditor of the CalPX with no outstanding obligations, then AHA's assigned claim would have no value.

19. The Commission does not agree with PG&E that the proposed agreement improperly seeks to impose recovery from PG&E and SCE for fees and costs related to the arbitration between CalPX and AHA. Pursuant to Section 14.3 of the CalPX's tariff, market participants, such as PG&E, are required to indemnify the CalPX for legal expenses arising from any act or omission of that market participant.⁷ To the extent that CalPX has rights or interests related to the \$300,000 in incurred legal expenses (and we do not address here whether CalPX, in fact, has any rights or interests), the Commission will permit CalPX to transfer or assign such rights or interests to AHA.

20. Finally, we will grant CalPX's petition for waiver of the filing fee.⁸ CalPX states that payment of the filing fee would cause "financial distress" because it would cause the expenditure of resources CalPX has no means of replacing.⁹ CalPX supports its petition by stating that (1) it has no operating revenues since it has not operated its exchange services since January 2001, and (2) its cash reserves are needed to complete the process of "winding-down" its business affairs. Based on these facts, we find that the PX has demonstrated that payment of the filing fee would place it in "financial distress."

The Commission orders:

(A) CalPX's petition for declaratory order is hereby granted, as discussed in the body of this order.

⁷Section 14.3 provides that "[e]ach PX Participant shall, to the extent permitted by law, indemnify the PX and hold it harmless against all losses, damages, claims, liability, costs or expenses (including legal expenses) arising from any act or omission of the PX Participant, except to the extent that they result from the PX's default under this Tariff or negligence or intentional wrongdoing on the part of the PX or its officers, directors or employees.

⁸On two previous occasions, the Commission has ruled that CalPX meets the criteria for waiver of the filing fee. See *California Power Exchange Corp.*, 98 FERC ¶ 61,097 (2002); and 100 FERC ¶ 61,124 (2002).

⁹See 18 C.F.R. § 381.106 (2003).

(B) CalPX's petition for waiver of the filing fee requirement is hereby granted, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.