

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;  
Nora Mead Brownell, Joseph T. Kelliher,  
and Suedeem G. Kelly.

California Power Exchange Corporation

Docket No. EL03-223-001

ORDER ON REHEARING

(Issued March 4, 2004)

1. On November 24, 2003, Pacific Gas and Electric Company (PG&E) filed a request for rehearing of the Commission's order issued on October 23, 2003.<sup>1</sup> In that order, that Commission granted a petition for declaratory order filed by the California Power Exchange Corporation (CalPX). On rehearing, PG&E argues that the Commission, for numerous reasons, erred in its determination to grant CalPX's petition. Upon review of PG&E's pleading, the Commission, in this order, grants in part, and denies in part, its request for rehearing.

**Background**

2. On August 14, 2000, American Home Assurance Company (AHA), in the capacity of a 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.<sup>2</sup> 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 PG&E to pay for trades in

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<sup>1</sup> California Power Exch. Corp., 105 FERC ¶ 61,101 (2003) (October 23 Order).

<sup>2</sup> The Core Market was the spot market for day-ahead and real-time electricity trading.

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 While SCE has since paid its obligations and CalPX has subsequently withdrawn its claim against the bond with regard to SCE's nonpayment, CalPX pursued its claim for \$20 million under the bond for PG&E's nonpayment.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 over one and one-half years.

4. On August 21, 2003, CalPX, in an attempt to settle this dispute, filed a petition for declaratory order requesting the Commission's approval of a proposed agreement between itself and AHA. CalPX explained that, if approved, the agreement would resolve its claim arising from PG&E's failure to pay its trading obligations in CalPX's Core Market. 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).

5. 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, the settlement provides that 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.

6. In the October 23 Order, the Commission approved the agreement between CalPX and AHA. The Commission found that 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.<sup>3</sup> Although PG&E argued that it would be premature to exonerate the \$20 million bond given that the trades made in the CalPX markets have not been fully resolved, the Commission found otherwise. The Commission held that CalPX's decision to immediately realize a \$7.5 million claim, and forgo the possibility that it might make a \$20 million claim in the future, was a reasonable decision in light of the circumstances.<sup>4</sup>

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<sup>3</sup> October 23 Order at P 16.

<sup>4</sup> Id. at P 17.

### **Request for Rehearing and Discussion**

7. In its request for rehearing, PG&E alleges that the October 23 Order: (1) erred by approving the settlement between CalPX and AHA; (2) failed to ensure that PG&E would not be subject to double liability if the settlement is allowed to stand; and (3) erred by approving CalPX's ability to assign its \$300,000 in legal expenses to AHA.

8. PG&E argues that by allowing CalPX to settle its claim with AHA for \$7.5 million, and exonerating the remainder of the \$20 million bond, the Commission has foreclosed the possibility of an even greater recovery of funds for the benefit of the Settlement Clearing Account (and hence, all market participants) in the event of future defaults by other market participants. PG&E contends that as a result of numerous Commission proceedings and investigations relating to market manipulation in the California markets, findings may result that ultimately show that market participants, like PG&E, may not owe money to CalPX for trades, but may actually be owed money from CalPX. PG&E therefore contends that it is premature to exonerate the bond until the conclusion of the Commission's proceedings related to the California power markets.

9. Additionally, PG&E believes that the Commission's approval of the settlement is inconsistent with other recent determinations where it has held that CalPX should retain market participant cash collateral, letters of credit, and guarantees until the conclusion of the refund proceeding. As such, PG&E asserts that the performance bond is similarly necessary to protect the parties' rights in the event of a market participant's default, and requests that the Commission should require that the bond be retained until proceedings related to the California power markets are concluded.

10. While the Commission recognizes PG&E's concern, the Commission must also weigh the settlement's concrete benefits (that can be realized immediately) against the possibility of a larger, yet uncertain, return in the future. As it stands, the Settlement Clearing Account is poised to receive \$7.5 million, with an additional \$300,000 to be deposited into CalPX's Operating Account. In light of the extended litigation that CalPX and AHA have already engaged in, concerning whether CalPX appropriately enforced its credit policies as to PG&E, there is a distinct possibility that CalPX may never be able to successfully collect against the \$20 million face value of the bond (even if it is later determined that other market participants have defaulted.)

11. The fact of the matter is that CalPX only has an actionable claim on the bond as a direct result of PG&E's failure to pay for its trades in the Core Market. CalPX may employ its reasonable judgment in evaluating whether to accept the settlement offer, or wait, and attempt to make a larger claim in the event that it is revealed that other market

participants have defaulted.<sup>5</sup> As we stated in the October 23 Order, the Commission will not second-guess CalPX's reasonable decision in this regard.

12. Additionally, while PG&E is correct that the Commission has required market participants to maintain levels of collateral and security until the refund proceeding has concluded, we will not impose such a requirement on this performance bond. The stated purpose of the bond was to provide CalPX's market participants with an additional level of security for trading in Core Market. The performance bond was never intended to serve as a primary backstop to protect against defaults by market participants. Moreover, the existing levels of cash collateral, letters of credit, and guarantees that are being held by CalPX are fundamentally different from the bond since such forms of security were posted by the market participants themselves. Accordingly, the Commission has found no reasonable basis to interfere with the settlement that was reached between CalPX and AHA. The decision whether to exonerate the remainder of the bond and accept the settlement is solely CalPX's to make.

13. In its second argument, PG&E contends that the October 23 Order failed to ensure that PG&E would not be subject to double liability (for the \$7.5 million) as a result of the terms of the settlement. PG&E understands that CalPX will forgo pursuing any further claim against PG&E for the \$7.5 million as a result of CalPX's assigning this claim to AHA. However, PG&E states that while this settlement provision addresses AHA's potential claims against PG&E under the assignment from CalPX, the Commission failed to consider that the performance bond also provides that defaulting market participants can be held separately liable by AHA for any draws that CalPX made on the bond.

14. PG&E explains that it should not be forced to litigate against AHA, for any separate claims AHA may make under the terms of the bond that are in addition to the settlement's assignment of CalPX's \$7.5 million claim. For example, PG&E states that if

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<sup>5</sup> In determining that the settlement was in the best interest of CalPX and the participants, CalPX stated that the settlement would end the arbitration proceeding with AHA and relieve CalPX, and ultimately its participants, from continuing to incur attorneys' fees and expert witness fees to proceed with depositions and discovery in the case, as well as prepare for, and present CalPX's case at trial. In addition, CalPX stated that certain employees who were involved in the events concerning the bond and CalPX's credit policies and would be needed as witnesses, are no longer with the company. Further, CalPX stated that its continued prosecution of this matter would come at a time when CalPX is devoting significant effort and resources to processing reruns and adjustments for the California Refund Proceeding. See CalPX's Petition at 7-8.

it is ultimately determined that PG&E does not owe payment under CalPX's assignment, AHA should not be able to pursue PG&E separately under the bond to recover the remaining amounts (or any amounts) that AHA is not entitled to under the assignment. As such, PG&E requests that the Commission clarify that AHA has no additional rights or claims to seek recovery from PG&E for any amounts under the bond.

15. The Commission agrees with PG&E that it should not be subject to double liability for the \$7.5 million, as it has described. While the Commission does not believe that it was ever the intent of the parties to the settlement to subject PG&E to such an outcome, the Commission clarifies that AHA may only pursue its single claim (up to \$7.5 million) against PG&E by operation of CalPX's assignment. As such, any provision contained in the bond that would permit AHA to separately seek an additional \$7.5 million is overridden by operation of the assignment contained in the settlement. The principles of equity and fairness would support no other outcome. Accordingly, the Commission grants PG&E's request for rehearing, in part, with respect to the issue of double liability.

16. Finally, PG&E asserts that the October 23 Order improperly allows AHA to pursue the \$300,000 in legal expenses from PG&E. PG&E argues that the costs incurred to litigate the bond have already been recovered through CalPX's wind-up charges and assessed to all market participants. However, as a result of CalPX's transfer of the right to recover the legal expenses to AHA, PG&E protests that such a result is unfair and discriminatory since these expenses would have otherwise been shared by all market participants.

17. The Commission finds that contrary to PG&E's argument, such a result is neither unfair nor discriminatory. The well-established principle of cost causation requires that costs should be allocated, where possible, to customers based on customer benefits and cost incurrence. We find that CalPX would not have incurred these legal expenses but for PG&E's defaulting on its obligations. Additionally, we find that PG&E had a contractual obligation to pay for any legal expenses that were incurred.<sup>6</sup> The only reason CalPX was recovering its litigation expenses through the wind-up charge was because there was no other means, at that time, to recover these expenses. However, now that a settlement has been reached that provides for the payment of these legal expenses by AHA, we do not find that it would be fair that these expenses be shared by all market participants.

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<sup>6</sup> Section 14.3 of CalPX's tariff clearly requires its market participants to indemnify CalPX for any legal expenses incurred that arise from an act or omission of a specific market participant. October 23 Order at P 19, n.7

18. Therefore, to the extent that CalPX has rights or interests in the legal expenses, the Commission will allow CalPX to transfer such rights or interests to AHA.<sup>7</sup> Additionally, if CalPX has not already done so, it is directed to appropriately credit the accounts of its market participants through the wind-up rate schedule so that there will be no double recovery of the \$300,000 in legal expenses (once from AHA's payment, and a second time from the market participants through the wind-up charges).

The Commission orders:

(A) PG&E's request for rehearing is denied, in part, as discussed in the body of this order.

(B) PG&E's request for rehearing is granted, in part, with respect to the issue of double liability, as discussed in the body of this order.

By the Commission.

( S E A L )

Linda Mitry,  
Acting Secretary.

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<sup>7</sup> The Commission, however, does not address whether CalPX, in fact, has any rights or interests related to the \$300,000 in incurred legal expenses. Id. at P 19.