UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	**)**	**Docket No. ER01-889-004**

ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO THE CALIFORNIA GENERATORS' MOTION FOR EXPEDITED ENFORCEMENT OF CREDITWORTHINESS ORDERS

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213, the California Independent System Operator Corporation ("ISO") hereby provides its Answer to the Motion for Expedited Enforcement of Creditworthiness Orders filed on September 10, 2001, by Duke Energy North America LLC, Duke Energy Trading and Marketing LLC, Dynegy Power Marketing, Inc., Mirant California, LLC, Reliant Energy Power Generation, Inc., and Williams Energy Marketing & Trading Company and affiliates (collectively, "Generators").[1] The ISO submits that the Generators have not shown a violation of the Commission's orders. Moreover, the circumstances that give rise to the Generators' concerns have been resolved. Accordingly, the Generators' Motion should be denied.

[1] Capitalized terms not otherwise defined have the meaning given them in Appendix A of the ISO Tariff.

I. BACKGROUND

In Amendment No. 36 to the ISO Tariff, the ISO proposed revisions to the Tariff that would in effect waive the sanctions of the ISO Tariff's creditworthiness requirements for certain entities that were creditworthy as of January 3, 2001, including two Investor Owned Utilities ("IOUs") – Southern California Edison Company and Pacific Gas and Electric Company – that were about to lose the Approved Credit Rating that established their creditworthiness. The amendment would have allowed the IOUs to continue to schedule Generation and Load despite the loss of the Approved Credit Rating, thereby facilitating the distribution of electricity to California's End-Use Customers.

On February 14, 2001, the Commission authorized the ISO to waive the existing creditworthiness requirement insofar as it applied to the IOUs using their own transmission facilities to deliver their utility-retained generation to their Loads (self-supplying), but barred the ISO from waiving this requirement for transactions involving third-party suppliers.[2] The Commission stated that it would allow the ISO to excuse the IOUs from posting security for third-party transactions if appropriate substitute credit-support arrangements were made for those transactions. The Commission indicated that an agreement with the California Department of Water Resources ("CDWR") or a state bond to back the IOUs' liabilities for third-party-supplied power could substitute for the IOUs' posting of such security.

On February 22, 2001, the California Generators filed a motion to compel, arguing that the ISO was incorrectly interpreting the February 14 Order as applying

[2] *California Independent System Operator Corporation, et al.*, 94 FERC ¶ 61,132 (2001).

only to scheduled transactions and not transactions made in real time (*i.e.*, transactions in the Imbalance Energy market or in response to emergency dispatch orders that are not scheduled). On April 6, 2001, the Commission granted the California Generators' motion and directed the ISO to ensure the presence of a creditworthy counterparty for all power that third-party suppliers provide to the IOUs, including power provided through real time transactions.[3]

In the current motion, the Generators assert that, because CDWR has not made payment for the Energy purchases that it is backing, the ISO has failed to comply with the Commission's orders. As further evidence of noncompliance, the Generators cite the ISO's recent temporary suspension of its practice of making payment on preliminary settlement statements. Finally, they assert that the ISO is violating the Commission's orders because CDWR is not backing payment for Uninstructed Energy that is produced when Generating Units must run at minimum levels in order to be available under the Commission's must-offer requirement,[4] but are not selected in the ISO's markets to provide Imbalance Energy.

II. ARGUMENT

A. The ISO Is Prepared to Implement Procedures for Payment by CDWR.

The gravamen of Generators' Motion is a complaint that they have not been paid for those transactions for which CDWR has provided credit support. As explained below, the delay in payment has derived from the lack of an agreed-upon

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[3] *California Independent System Operator Corporation, et al.,* 95 FERC ¶ 61,026 (2001).

[4] *See San Diego Gas & Electric Co. v. All Sellers of Energy and Ancillary Services in to Markets Operated by the California Independent System Operator Corporation and the California Power Exchange,* 95 FERC ¶ 61,115 at 61,355-57; (April 26, 2001), 95 FERC ¶ 61,418 at 62,551-53 (June 19, 2001).

mechanism by which CDWR – who, although, a guarantor is not the debtor under ISO settlement procedures – could make payments on behalf of the IOUs. The ISO recognizes the legitimacy of this concern, and has been diligently working with CDWR to resolve the issues that have arisen regarding these procedures. Nonetheless, as explained below, this delay has nothing to do with the ISO's compliance with the Commission's orders on creditworthiness.

Fortunately, the ISO and CDWR have recently reached agreement on an appropriate mechanism to facilitate the flow of dollars, which will render the Generators' concerns moot. An explanation of these procedures, including detailed examples, has been posted on the ISO web-site and presented to the ISO Board for the Board's information. No action was needed or taken by the Board. As described in the posted materials, by using cash management, the proposed procedures provide for CDWR to assume a portion of the IOU's invoiced payables in accordance with an appropriate implementation agreement between CDWR and each IOU. Further, to assure that suppliers are paid in accordance with the Commission's creditworthiness orders, CDWR will, under specific conditions, also acquire a portion of the suppliers' invoice receivables. This latter procedure, which will also require an implementation agreement, is designed to determine amounts that CDWR will pay suppliers directly prior to the ISO settlement timelines, thereby extinguishing claims of unpaid amounts until the normal operation of the ISO market can be restored. While the ISO does not believe that the last agreement is necessary to implement the revised cash clearing procedure, it will guarantee payment earlier for suppliers.

B. The Generators Have Not Shown a Violation of the Commission's Orders on Creditworthiness

The Generators' Motion is grounded in its baseless assertion that the ISO has misled the Commission regarding the ISO's compliance with the Commission's orders regarding creditworthiness and with the ISO Tariff provisions implementing those orders. The fundamental flaw in the Generators' accusation is their failure to distinguish two functions of the ISO: the ISO's responsibility to ensure a creditworthy buyer and the ISO's role as settlement agent.

1. The ISO Has Not Violated Its Obligation to Ensure a Creditworthy Buyer

The Commission's orders require the ISO, when making purchases on behalf of a Scheduling Coordinator that fails to meet the ISO's creditworthiness requirements, to obtain assurances of payment from a creditworthy third party. The ISO has done so. As the ISO informed the Commission in the transmittal letter to its May 11, 2001, compliance filing in this Docket, CDWR accepted the responsibility for providing credit support for purchases on behalf of the IOUs. In response to protests of the compliance filing, the ISO provided the Commission with the letter memorializing this agreement, which was executed by the ISO and CDWR and was sent to the same Generators that bring this motion. CDWR has not reneged on that commitment, and the ISO has no reason to believe that it will. The ISO has therefore at all times been in compliance with the Commission's orders regarding creditworthiness.

2. The ISO Has Not Violated Its Responsibilities As Settlement Agent

The ISO's role as settlement agent is distinct from its enforcement of the ISO Tariff's creditworthiness requirements. Under Section 11 of the ISO Tariff, the ISO is responsible for collecting amounts owed from Scheduling Coordinator debtors and distributing amounts payable to Scheduling Coordinator creditors. Imbalance Energy and Ancillary Service costs are billed to the Scheduling Coordinator for the responsible Load for which they are responsible. These settlement provisions were not initially drafted to accommodate third-party guarantors. The ISO's settlement provisions thus required the ISO to invoice the IOUs for the purchases backed by CDWR.[5]

Therefore, although CDWR had agreed to provide credit assurances for purchases on behalf of the IOUs, the mechanism by which CDWR was to make the necessary payments remained to be developed. As discussed above, after extensive discussions, the ISO and CDWR have developed a process to accommodate CDWR's payments within the mechanisms established by the ISO Tariff.

Despite these complications, the ISO has remained in compliance with the tariff provisions regarding its role as settlement agent. Pursuant to the ISO Tariff, the ISO billed the IOUs – the Scheduling Coordinators – for Imbalance Energy and Ancillary Services procured on behalf of their Loads. The ISO, however, is only authorized and required to distribute amounts in its Clearing Account and Reserve

[5] Thus, the Generators assertion that the ISO has violated the ISO Tariff by failing to bill CDWR for the Imbalance Energy and Ancillary Services purchases that it has backed, Motion at 6 n. 8, are simply wrong.

Account, i.e., amounts it has received from Debtors or as security deposits. The ISO Tariff does not require the ISO to act as a collection agent.

The Generators are no worse off in this regard than prior to the issues regarding the IOUs' creditworthiness. If IOUs were creditworthy, the ISO could purchase Imbalance Energy and Ancillary Services on their behalf consistent with its responsibilities regarding creditworthiness. A default on the part of a creditworthy IOU would not preclude the ISO from continuing to make such purchases on its behalf. Although the ISO *may* require credit assurances under such circumstances, it is not required to do so.

Indeed, some of the Generators bringing this motion have chosen to net their debits and credits to the ISO in a manner contrary to the ISO Tariff and are therefore *themselves* in default. Under their interpretation of the ISO's responsibilities, the ISO could not schedule transactions for these Generators.

Quite simply, the ISO Tariff requires the ISO to ensure that Scheduling Coordinators are creditworthy or, following the Commission's orders, to find a creditworthy third party to guarantee payment for the Scheduling Coordinator. The ISO Tariff does not require the ISO itself to become a guarantor and ensure that creditworthy parties abide by their payment obligations. Nothing in the Commission's orders requires to the contrary.

C. The ISO's Modification of the Settlement Schedule Is Irrelevant to the ISO's Performance of Its Obligations Regarding Creditworthiness

In the course of their argument, the Generators point to the ISO's suspension of the practice of making payments based on preliminary invoices. It is difficult to

understand how this event relates to the Commission's orders regarding creditworthiness, let alone constitutes a violation thereof, and the Generators provide no enlightenment in that regard.

Nonetheless, the Generators' complaints about the ISO's modification of its settlement practices are groundless. These modifications are necessary to ensure that the impacts of defaults are fairly shared among Market Participants. In the letter attached to the Motion as Exhibit 5, the ISO explained that certain Scheduling Coordinators have been netting amounts owed to them from current obligations to the ISO. Such netting is impermissible under the ISO Tariff because any shortfall in receipts must be shared pro rata among Scheduling Coordinators. In this case, the failure of certain Scheduling Coordinators to pay their initial invoices in full has resulted in insufficient funds to pay those that did pay the initial invoices in full, but are owed sums because of adjustments in the final invoice. The result of the netting is inappropriate cost-shifting.

In order to limit the opportunity for improper netting, the ISO filed Amendment No. 40 to the ISO Tariff, which would temporarily eliminate the process of paying initial invoices. The ISO requested an effective date of August 1, 2001, and implemented the new procedures accordingly. The ISO served Amendment No. 40 upon the Generators and posted it on the ISO Home Page prior to the filing of this motion. Generators who object to the modified procedures can protest Amendment No. 40 in accordance with Commission procedures. The Commission should not countenance the Generators' effort to avoid appropriate procedures under the guise of this Motion regarding creditworthiness requirements.

D. Issues Regarding Payment for Running at Minimum Load Are Not Creditworthiness Issues

Finally, Generators complain that the ISO is not complying with creditworthiness orders because CDWR is not providing credit support for Uninstructed Imbalance Energy provided in those hours when Generators with long start-up times have not been dispatched by the ISO, but must nonetheless be on-line in order to comply with the must-offer requirement in other hours. This is not a creditworthiness issue. The Commission's creditworthiness requirement can logically only apply when the ISO enters into transactions, i.e., when it dispatches Energy, not in connection with Energy that the ISO has not requested but is nonetheless produced by a Generator – for operational reasons or otherwise. Nonetheless, the ISO recognizes the Generators' concerns. It is therefore discussing with CDWR compensation for Uninstructed Imbalance Energy when a Generator must operate at minimum levels due to the must-offer requirement. CDWR has been responsive to the concerns raised by the ISO.

The underlying issue, of course, is the manner in which the must-offer requirement applies to Generators with long start-up times. In its compliance filing for the Commission's June 19th Order,[6] the ISO recognized this problem and pledged to work with Generators to develop a solution. In the interim, the ISO concluded that such Generators must comply with the letter of the June 19th Order, and could make up any shortfall (such as the difference between the Market Clearing Price and variable costs) by Ancillary Services sales and by Energy sales during peak periods. The Generators have challenged this conclusion in protests of

[6] *See* n. 1, supra.

the ISO's compliance filing. If the ISO and the Generators cannot develop a solution to this concern, the Commission will resolve it in the appropriate docket. It has nothing to do with creditworthiness.

III. CONCLUSION

For the reasons described above, the Commission should deny the Generators' Motion.

Respectfully submitted,

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Dated: September 25, 2001

September 25, 2001

VIA MESSENGER

David P. Boergers, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: California Independent System Operator Corporation
Docket No. ER01-889-004

Dear Secretary Boergers:

Enclosed for filing are one original and fourteen copies of the Answer of the California Independent System Operator Corporation to the California Generators' Motion for Expedited Enforcement of Creditworthiness Orders in the above-cited proceeding. Two additional copies of the filing are also enclosed.

I would appreciate your stamping the additional copies with the time/date stamped and returned to us by the messenger. Thank you for your assistance.

Respectfully submitted,

Michael E. Ward
Counsel for the California Independent System Operator Corporation

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 this proceeding.

Dated at Washington, DC, on this 25th day of September, 2001.

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Michael E. Ward