UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	**)** **)**	**Docket No. ER01-889-005**

MOTION FOR LEAVE TO RESPOND ONE DAY OUT-OF-TIME AND ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO MOTIONS TO INTERVENE, COMMENTS, MOTION FOR LEAVE TO FILE PROTEST OUT-OF-TIME, CONDITIONAL PROTEST, AND PROTESTS OF THE MAY, 11, 2001 COMPLAINCE FILING

On May 11, 2001, the California Independent System Operator Corporation ("ISO")[1] submitted a compliance filing in the above-captioned docket as directed by the Commission's April 26, 2001 letter order in this proceeding ("April 26 Letter Order"). The compliance filing implemented the conditions specified in the Commission in its April 6, 2001 order in this proceeding.[2] The Commission's May 16, 2001 Notice of Filing in this proceeding directed parties to comment on the ISO's proposed Tariff revisions (the "May 11 Compliance Filing") on or before June 1, 2001.

Pursuant to Rules 212 and 213 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("Commission"), 18 C.F.R. §§ 385.212 and 385.213 (2000), the ISO now submits its motion for leave to respond one day out-of-time and answer to the motions to intervene, comments,

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[1] Capitalized terms not otherwise defined herein are defined in the Master Definitions Supplement, Appendix A to the ISO Tariff.

[2] *California Independent System Operator Corp. et al.*, 95 FERC ¶ 61,026 (2001) ("April 6 Order").

motion for leave to file protest out-of-time, conditional protest, and protests. The ISO does not oppose the intervention of any party that has sought leave to intervene in this proceeding. For the reasons explained below and in the attached documents, however, the comments and protests that seek the rejection or substantive modification of the ISO's May 11 Compliance Filing are without merit.[3] The Commission should accept the ISO's proposed Tariff revisions without condition.

I. BACKGROUND

The ISO filed Amendment No. 36 in this proceeding on January 4, 2001, after it became apparent that the financial well-being of Southern California Edison Company ("SCE" or "SoCal Edison") and Pacific Gas and Electric Company ("PG&E") was deteriorating rapidly. A downgrade in the credit ratings of those companies, and of the California Power Exchange ("PX"), which represented SCE and PG&E as a Scheduling Coordinator (and whose financial well-being in this capacity was linked to that of SCE and PG&E), was inevitable. Under Section 2.2.7.3 of the ISO Tariff, such a downgrade would preclude the ISO from accepting any advance Schedules submitted by the PX, representing those companies, or from one of the companies, unless the PX or company first

[3] Attached as part of this Answer are the following documents: (A) April 13, 2001 Market Notice Regarding Credit Issues; (B) May 25, 2001 Supplemental Market Notice Regarding Credit Issues; (C) May 27, 2001 Emergency Notice Regarding May 25, 2001 FERC Order On Implementation of the Price Mitigation Plan in April 26 Order; (D) January 20, 2001, Letter from California Department of Water Resources ("CDWR" or "DWR") and ISO to Lynn Lednicky - Dynegy Marketing & Trade *et al.* and January 21, 2001 Market Notice concerning the agreement between ISO and CDWR under State Law SB7X; (E) February 7, 2001 Letter from CDWR to Jack Farley - Reliant Energy; (F) April 13, 2001 letter signed by CDWR authorizing release of April 13, 2001 Market Notice; (G) Confidentiality, Non-Disclosure and Use of Information Agreement between the ISO and CDWR; and (H) Declaration of James W. Detmers, ISO Vice President of Grid Operations filed in the PG&E bankruptcy proceeding.

posted financial security in accordance with Section 2.2.3.2. Due to their financial status, it was similarly apparent that PG&E, SCE and the PX were also unable to maintain such security. Therefore, in Amendment No. 36, the ISO proposed to waive, on a day-to-day basis, the limitations set forth in Section 2.2.7.3 with respect to Scheduling Coordinators that are temporarily unable to satisfy the creditworthiness provisions of its Tariff in order to allow Edison and PG&E to continue to schedule with the ISO.

On February 14, 2001, the Commission issued its "Order Addressing Creditworthiness Tariff Provisions Proposed by the California Independent System Operator and the California Power Exchange,"[4] in which it conditionally accepted Amendment No. 36, subject to clarification and guidance. In particular, the Commission accepted Amendment No. 36 insofar as it allowed scheduling the Loads of Edison and PG&E against Generation that these entities own or control, but rejected it insofar as it allowed scheduling of those Loads against resources owned or controlled by third parties. In response to the ISO's request for guidance going forward, the Commission stated that the relaxation on the scheduling restrictions with regard to third parties would be acceptable if combined with appropriate support from creditworthy counter-parties. The Commission ordered the ISO to file modifications to the ISO Tariff in compliance with the February 14 Order within 15 days.

[4] *California Independent System Operator Corp. et al.*, 94 FERC ¶ 61,132 (2001) (the "February 14 Order").

On February 22, 2001, various Participating Generators in California (hereafter the "California Generators") filed a motion alleging that the ISO had failed to comply with the February 14 Order and requested that the Commission issue an emergency order requiring the ISO to obtain a creditworthy guarantor for all real-time Energy transactions, including emergency dispatch orders. The ISO filed its Answer to this request on February 27, 2001.

On March 1, 2001, the ISO filed a compliance filing as directed by the Commission in the February 14 Order. Therein, the ISO submitted revised Tariff language allowing the ISO to accept schedules to serve the Load of a Utility Distribution Company ("UDC") that no longer meets the creditworthiness requirements of the Tariff if the Load is to be served from one of three types of resources: (1) a resource that the UDC owns; (2) a resource that the UDC has under contract to serve its Load; or (3) a resource from which another entity has purchased Energy or with regard to which another entity has provided assurance of payment for Energy on behalf of the UDC, if that entity has an Approved Credit Rating or has posted security pursuant to Section 2.2.7.3.

In the April 6 Order, the Commission indicated that it was granting the California Generators' February 22 motion, and declared that the ISO had misinterpreted its February 14 Order. The Commission stated that the February 14 Order "did not exempt any transactions from the requirement to have in place a creditworthy buyer" but instead required "third-party suppliers assurances of a creditworthy buyer for all energy delivered to the loads through the ISO." April 6

Order, 95 FERC at 61,081. The Commission directed the ISO to "comply with the February 14 Order" consistent with its discussion in the April 6 Order.

On April 26, 2001, the Commission sent to the ISO's counsel a letter indicating that the ISO's March 1, 2001, compliance filing was deficient in light of the Commission's April 6 Order, and directing the ISO to file Tariff modifications consistent with the April 6 Order within 15 days of the date of the letter. Pursuant to this directive, the ISO, on May 11, 2001, filed Tariff modifications implementing the conditions specified in the April 6 Order.[5] Therein, the ISO advised the Commission that CDWR was the only party that has stepped forward to provide the credit support required by the Commission with respect to transactions undertaken through the ISO for the benefit of the End-Use Customers of PG&E and Edison that is not satisfied by Generation that these entities own or control, including Generation under contract. The ISO also explained that, although CDWR had indicated its willingness to back certain ISO transactions, it had also advised the ISO that it required access to the ISO control room floor and to certain non-public information as a condition to the continued provision of such credit support. Absent CDWR's willingness to step in to provide the financial assurance required by the Commission, the ISO would have no ability – in light of the credit requirements prescribed by the Commission for real-time operations – to discharge its fundamental reliability responsibility.

[5] The May 11 Compliance Filing was submitted under protest due to the ISO's then-pending May 7, 2001, request for rehearing of the April 6 Order. The Commission denied this request in an order issued on June 13, 2001. *California Independent System Operator Corp.*, 95 FERC ¶ 61,391 ("June 13 Order").

To the extent that the Commission did not agree that the ISO's provision of certain information to CDWR in this capacity falls outside the subject matter of the Commission's standards of conduct regulations, the ISO explained that CDWR's unique role in the current extraordinary crisis and the urgency of the situation facing California warranted a limited exemption from the standard of conduct regulations.

The ISO had previously released a market notice addressing how the ISO would comply with the Commission's April 6 Order on credit support. A copy of that market notice, issued on April 13, 2001 (the "April 13 Market Notice"") is provided as Attachment A to this Answer. On May 25, 2001, the ISO issued a supplemental Market Notice on credit issues ("May 25 Market Notice") providing further details concerning the ISO's compliance with the April 6 Order (and therefore, implementation of its May 11 Compliance Filing). Specifically, the May 25 Market Notice, which is provided as Attachment B to this Answer, states, in relevant part:

> Pending rehearing, unless the ISO can provide reasonable assurances that a party meeting the ISO's credit requirements will support a specific transaction, the ISO will not enter into the transaction with respect to any resource. This includes (1) awarding capacity bids in the forward Ancillary Service ("AS") markets and (2) dispatching Imbalance Energy bids in the real time market. Therefore, the ISO will not award AS capacity bids nor will it dispatch Imbalance Energy bids above the prices for which CDWR will agree to provide credit backing. Imbalance Energy bids above the prices for which CDWR has agreed to provide credit backing, though not accepted, shall remain in the "BEEP" stack. Accordingly, in accordance with ISO Tariff §§ 5.1.3 and 11.2.4, resources will not be subject to Out-Of-Market calls unless the ISO has secured a creditworthy buyer for these unawarded Supplemental Energy Bids. See, e.g., ISO Tariff §§ 5.6.2 and 5.1.3.

On the same date, the Commission issued an order that, in part, addressed credits support issues in response to a motion for clarification filed the Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California ("Southern Cities").[6] In that order,[7] the Commission granted the Southern Cities motion for clarification, stating that:

> We have previously ruled that generators are entitled to assurances of payment for all energy they provide through the ISO and have directed the ISO to ensure the presence of a creditworthy counterparty for all power that any third-party suppliers provide to PG&E and SoCal Edison.

In response to the May 25 Order, the ISO issued a further market notice (the "May 27 Market Notice") advising Market Participants of the May 25 Order and confirming once again that "the ISO will continue to comply with the FERC's orders regarding creditworthiness." A copy of the May 27 Market Notice is provided as Attachment C to this Answer.

As noted above, on June 13, 2001, the Commission issued its "Order Denying Rehearing of California ISO Creditworthiness Order." In the June 13 Order, the Commission denied the ISO's request for rehearing and held that "it would be reasonable to require that the ISO obtain prior assurances of payment for all third-party power supplied to SoCal Edison and PG&E, whether directly or

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[6] This order was issued on the same day that responses to the Southern Cities motion were due and the same day that the ISO filed its answer explaining that arrangements were already in place to provide credit assurances for all supplier's providing Energy under the Commission's "must-offer" requirement, the very issue on which Southern Cities sought clarification.

[7] *San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange, et al.*, 95 FERC ¶ 61,275 ("May 25 Order").

through purchases by DWR (or another creditworthy counterparty) on their loads' behalf." June 13 Order, 95 FERC ¶ 61,391, slip op. at 11.

The Commission's May 16, 2001, Notice of Filing required that all interventions, comments, and protests concerning the May 11 Compliance Filing be filed by June 1, 2001. On that date, a number of parties filed motions to intervene, comments, and motions concerning the May 11 Compliance Filing.[8] One party, Duke Energy, North American, LLC and Duke Energy Trading and Marketing, LLC ("Duke"), filed a motion for leave to protest out-of-time and protest in this proceeding on June 6, 2001.[9] The ISO does not oppose the intervention of any party in this proceeding. As explained below, however, the comments and protests of those parties in opposition to the May 11 Compliance Filing are without merit and should be rejected. The ISO accordingly requests that the Commission accept the Tariff revisions proposed in the May 11 Compliance Filing, without condition or substantive modification, as bringing the ISO in full compliance with the April 6 Order and the April 26 Letter Order.

[8] These parties include CDWR; Dynegy Power Marketing, Inc., El Segundo Power, L.L.C., Long Beach Generation, L.L.C., Cabrillo Power I, L.L.C., and Cabrillo Power II, L.L.C. ("Dynegy"); Mirant California, LLC, Mirant Delta, LLC and Mirant Potrero, LLC ("Mirant"); Northern California Power Agency ("NCPA"); Reliant Energy Power Generation, Inc. and Reliant Energy Services, Inc. ("Reliant"); the Electric Power Supply Association ("EPSA"); Southern California Edison Company ("Edison"), Pacific Gas and Electric Company ("PG&E); the Official Committee of Unsecured Creditors of Pacific Gas and Electric Company ("Creditors Committee); the Sacramento Municipal Utility District ("SMUD"); the Modesto Irrigation District ("Modesto"); and NRG Power Marketing, Inc. and Neo California Power LLC.

[9] The ISO notes that the sole justification for Duke's filing five days after the deadline established by the March 16 Notice of Filing is its need to review of the May 25 Order, issued a week before that deadline. Nonetheless, the ISO does not oppose the motion for leave to file protest out-of-time. For the reasons explained below, however, the ISO believes that Duke's protest is without merit.

II. MOTION FOR LEAVE TO RESPOND OUT OF TIME

Pursuant to 18 C.F.R. § 385.213(d), answers to motions or comments are generally due fifteen days after the filing of such motions or comments unless the Commission otherwise orders. Motions to intervene, comments and protests on the May 11 Compliance Filing were due on June 1, 2001, making this Answer one day out-of-time. The ISO was unable to finalize this Answer for filing yesterday in part because key ISO personnel were needed to address other pressing matters including the threat of rolling blackouts in the ISO Control Area and the Commission's meeting concerning market power mitigation in the Western Interconnection. Accepting this Answer one day out-of-time is in the public interest, as the information provided in this Answer and the attachments thereto will assist the Commission in determining how to proceed with regard to this matter and will ensure the development of a complete record. In addition, acceptance of this Answer one day out-of-time will place no burden on any other party in this proceeding.[10] Therefore the ISO respectfully requests the Commission accept this Answer one day out-of-time.

[10] The ISO notes that it is not objecting to the motion of another party in this proceeding for leave to file a protest five days out-of-time. In addition, even though this protest was filed five days out-of-time, the ISO is responding to certain arguments made in that protest in the instant Answer.

III. ANSWER TO COMMENTS AND PROTESTS[11]

A. The Proposed Tariff Revisions Comply with the Commission's Orders in This Proceeding

A number of parties complain that the Tariff revisions proposed in the May 11 Compliance Filing do not clearly comply with the Commission's directive in the April 6 Order that the ISO "ensure the presence of a creditworthy counterparty for all power that third-party suppliers provide to PG&E and SoCal Edison, including power provided through real-time transactions."[12] These complaints are without merit. They amount to nothing less than the latest in a round of repeated and unsubstantiated allegations that the ISO has not been complying with the April 6 Order. As the ISO has explained in the attached Market Notices and in numerous filings with this Commission, the ISO has complied with that order (and subsequent orders relating to creditworthiness) notwithstanding the ISO's objections as to the legal basis for those orders.[13]

There is also no basis for the specific objections to the Tariff language proposed by the ISO in the May 11 Compliance Filing. The ISO's Tariff revisions

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[11] Some of the Intervenors commenting substantively on the May 11 Compliance Filing do so in portions of their pleadings variously styled as "Comments," "Conditional Protest," or "Protest," without differentiation. There is no prohibition on the ISO's responding to the comments or motions in these pleadings. The ISO is entitled to respond to these pleadings and requests notwithstanding the label applied to them. *Florida Power & Light Company*, 67 FERC ¶ 61,315 (1994). In the event that any portion of this answer is deemed an answer to protests, the ISO requests waiver of Rule 213 (18 C.F.R. §385.213) to permit it to make this answer. Good cause for this waiver exists here given the nature of this proceeding and the usefulness of this answer in ensuring the development of a complete record. *See, e.g., Enron Corporation*, 78 FERC ¶ 61,179 at 61,733, 61,741 (1997); *El Paso Electric Company*, 68 FERC ¶ 61,181 at 61,899 and n. 57 (1994).

[12] *See* June 13 Order, 95 FERC ¶ 61,391, slip op. at 3.

[13] *See* May 25, 2001, Answer of the California Independent System Operator Corporation to Motion for Clarification of the Cities of Anaheim, Azusa, Banning, Colton and Riverside, California, filed in Docket Nos. EL00-95-000, *et al.* at 4-5; June 7, 2001, Answer of the California Independent System Operator Corporation in Opposition to Expedited Motion for Enforcement Action, filed in Docket Nos. ER01-889-003, *et al.* at 4.

clearly indicate the creditworthiness requirements of Section 2.2.3.2 apply to "all transactions in an ISO Market" and that the ISO "will only instruct the dispatch of Imbalance Energy" on behalf of a Scheduling Coordinator that is creditworthy or to the extent that another entity (a "creditworthy counterparty" in the vernacular of the Commission's orders) "has provided assurance of payment on behalf of the Scheduling Coordinator." Some parties argue that the proposed Tariff revisions do not clearly apply to the ISO's procurement of Ancillary Services or to the ISO's "out-of-market" dispatch of Generators that have not submitted bids pursuant to its emergency dispatch authority under the ISO Tariff.[14] This is not the case. The term "ISO Market" is defined as "Any of the markets administered by the ISO under the ISO, including without limitation, Imbalance Energy, Ancillary Services, and FTRs." Imbalance Energy under the ISO Tariff is defined as "Energy from Regulation, Spinning and Non-spinning Reserves, or Replacement Reserves, or Energy from other Generating Units, System Resources or Load that are able to respond to the ISO's request for more or less Energy." Thus, Energy that the ISO procures through negotiated agreements (so-called out-of-market requests) fall within the definition of Imbalance Energy. Furthermore, the ISO's procurement of Ancillary Services is plainly within the definition of "transactions in an ISO Market." [15]

The Tariff revisions submitted in the May 11 Compliance Filing also apply to the dispatch of Imbalance Energy under the ISO's emergency dispatch

[14] *See*, *e.g.*, Duke at 4-5; Reliant at 4-7.

[15] That the ISO is complying with the April 6 Order with respect to Ancillary Services is further confirmed by the ISO's May 25 Market Notice.

authority. Such emergency dispatch instructions fall within the revised Tariff language providing that the ISO "will only instruct the dispatch of Imbalance Energy" to the extent there is a creditworthy purchaser or counterparty to that transaction. As Reliant, EPSA and other parties acknowledge, the May 25 Market Notice provided further clarification on the issue of credit support for emergency dispatch orders. Moreover, in its June 13 Order, the Commission stated that:

> The ISO tariff does not allow suppliers to ignore emergency dispatch orders. We also find nothing unjust or unreasonable in providing that suppliers must comply with ISO emergency dispatch orders while enforcing their right to credit assurance by filing complaints with the Commission, rather than by ignoring ISO orders issued in the middle of the emergency.[16]

There is no need for further clarification. As such, there is no justification for the Tariff revisions proposed by Duke.

Mirant argues that the language in the May 11 Compliance Filing indicating that the creditworthiness requirements in Section 2.2.3.2 apply to the "ISO's acceptance of scheduled transactions" should be deleted.[17] This change is not only unnecessary but would be plainly contrary to the Commission's April 6 Order. In that order, the Commission held that "the ISO's creditworthiness requirements apply whether transactions are scheduled or not." April 6 Order, 95 FERC at 61,081. The Tariff language submitted May 11 Compliance Filing

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16 June 13 Order, 95 FERC ¶ 61,391, slip op. at 8.

17 Mirant at 3.

similarly applies to both scheduled and unscheduled transactions in ISO Markets.[18]

B. The ISO's Arrangements with CDWR Are in Compliance With FERC's Orders on Credit Support Issues

A number of parties claim that the fact that CDWR has indicated a willingness to provide credit backing for only "certain transactions" means that the ISO is not in full compliance with the April 6 and May 25 Orders.[19] Unsurprisingly, these claims are presented as pure rhetoric, without any evidence to suggest that the ISO is not complying with those orders. Conversely, the ISO has provided the Commission with evidence of its compliance with those orders. Specifically, in response to Dynegy's Expedited Motion For Enforcement Action in this proceeding, the ISO provided the Commission with a Declaration of Mr. James W. Detmers, the ISO's Vice President of Grid Operations, that was recently filed in the Bankruptcy proceeding involving Pacific Gas and Electric Company. In that declaration, a copy of which is provided as Attachment H to this answer, Mr. Detmers states that, since April 6, 2001, the ISO has "not entered into any real time transaction unless a creditworthy party has provided assurances of payment."

It is apparent that objections to CDWR's willingness to provide credit backing for only "certain transactions" are nothing more than a poorly concealed attempt to convert the Commission's directives that the ISO "obtain prior assurances of payment for all third-party power supplied to SoCal Edison and

[18] "The creditworthiness requirements in this section apply to the ISO's acceptance of Schedules *and* to all transactions in an ISO Market" (emphasis added).

PG&E, whether directly or through purchases by DWR (or another creditworthy counterparty) on their loads' behalf"[20] into a requirement that CDWR commit to back all ISO purchases, regardless of the price at which the Energy is offered for sale. While it is easy to surmise why suppliers of Energy and related services would desire CDWR to sign such a blank check in its favor, the Commission's orders on credit issues do not, and could not impose such requirement.[21] As CDWR notes in its comments supporting the May 11 Compliance Filing, CDWR is simply exercising its discretion as a purchasing agent to determine what transactions it will support versus what transactions it will not support. The Commission has long recognized that entities responsible for making purchasing decisions on behalf of Load-serving entities can exercise such discretion.[22] To the extent that CDWR or another creditworthy counterparty fails to provide financial support for transactions in the ISO Markets or the dispatch of Imbalance Energy needed to serve the "net short" demand of customers in PG&E and SoCal Edison's Service Areas, the ISO may have no choice but to curtail service to those customers. The Commission has recently affirmed its conclusion that such a result is compelled by the Federal Power Act. June 13 Order, 95 FERC ¶ 61,391.

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19 *See, e.g.,* Dynegy at 1-2; SCE at 3; Duke at 9-10.

20 June 13 Order, 95 FERC ¶ 61,391, slip op. at 11.

21 As the Commission is aware, CDWR is a public entity not subject to the Commission's jurisdiction is such matters.

22 *See, e.g.*, *AES Redondo Beach*, *et al.*, 85 FERC ¶ 65,123 (1998) (authorizing the establishment of purchase price caps in the ISO's Ancillary Service markets because the ISO, as a purchaser of services in these markets, had the right to limit the prices it was willing to pay for those services); *California Independent System Operator Corp.*, 86 FERC ¶ 61,059 (1999) (granting an extension of the ISO's purchase price cap authority in its Imbalance Energy and Ancillary Services markets for the same reason).

Duke argues that the ISO must demonstrate that CDWR qualifies as a "creditworthy party."[23] This argument ignores the Commission's numerous statements confirming that the support of CDWR satisfies its directives on credit support for transactions in ISO Markets and the dispatch of Imbalance Energy.[24] Moreover, Duke fails to acknowledge that CDWR is the only party that has stepped forward to provide the credit support with respect to transactions undertaken through the ISO for the benefit of the End-Use Customers of PG&E and Edison that is not satisfied by Generation that these entities own or control, including Generation under contract.

C. The ISO's Credit Support Arrangements with CDWR Do Not Violate the Commission's Standards of Conduct or ISO Tariff Provisions Regarding Treatment of Market Participants

A number of parties argue about the ISO's statement concerning CDWR's access to the ISO control room and certain non-public information. They claim that this arrangement is contrary to the Commission's standards of conduct for transmission providers. However, the ISO and CDWR have taken measures to ensure the confidentiality and limited use of any information provided to CDWR in its capacity as the California Energy Resources Scheduler ("CERS"), *i.e.*, in its role as a financial backer and purchaser on behalf of the retail customers of the California Investor-Owned Utilities ("IOUs"). The ISO acknowledges that CDWR

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[23] Duke at 8.

[24] April 6 Order, 95 FERC at 61,080 ("For transactions involving third-party suppliers, the Commission required a creditworthy counterparty, such as the California Department of Water Resources."); June 13 Order, 95 FERC ¶ 61,391, slip op. at 10-11 ("We . . . conclude that it would be reasonable to require that the ISO obtain prior assurances of payment for all third-party power supplied to SoCal Edison and PG&E, whether directly or through purchases by DWR (or another creditworthy counterparty) on their loads' behalf").

has traditionally bid a limited amount of Load and Generation from the State Water Project into the ISO Markets and in that capacity is properly considered a "Market Participant" under the ISO Tariff. At the start of this year, however, CDWR was authorized by the California legislature to assume a new and wholly distinct role. In this new role, CDWR was authorized to contract for, and back the purchases of Energy, on behalf of the customers of California IOUs. As the Commission is aware, these California IOUs have been in severe financial distress due to the excessive wholesale power costs that suppliers of Energy have been permitted to charge for more than the past year.

Senate Bill 7X ("SB7X"), signed by the Governor on January 18, 2001, allowed CDWR to make purchases from any party and make such Energy available to the ISO and others, for up to twelve days and $400 million. SB7X became inoperative on February 2, 2001, by which time it had been superseded by Assembly Bill 1X ("AB1X"). On February 1, 2001, the California Legislature enacted, and the Governor signed, AB 1X, which authorizes CDWR to purchase energy for the "net short" power requirements of the IOUs.[25] The "net short" requirement is the amount of power that is needed to serve the Demand of the IOUs' customers less the power provided by Generation owned or controlled by those utilities.[26]

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[25] *See* the discussion of this issue, *infra*.

[26] As discussed further below, although AB1X modified the Water Code to provide DWR with this authorization, the statute makes it explicitly clear that PG&E and the other IOUs retain their primary responsibility to provide service to the End-Use Customers in their Service Area.

Since CDWR first assumed this new role, the ISO has endeavored to provide Market Participants with information about the nature of its arrangements with CDWR in its role as a purchaser and backer of purchases on behalf of the End-Use Customers of the California IOUs. On January 20, 2001, within two days of the enactment of SB7X, the ISO and CDWR released a letter to a number of Market Participants who had inquired about the nature of arrangements between the ISO and CDWR. The ISO also issued a Market Notice with the text of this letter.[27] On February 7, 2001, in response to a letter from Reliant Energy to CDWR and the ISO, CDWR provided a letter to Reliant Energy "regarding purchasing power supplied to the CAISO on a real time basis."[28] As described above, CDWR also authorized the ISO to release the April 13 Market Notice describing the terms under which CDWR would provide credit support for certain ISO Market transactions to facilitate the ISO's compliance with the Commission's April 6 Order.[29]

CDWR, in its capacity as a financial backer and purchaser on behalf of the End-Use Customers of the California IOUs, is not a typical Market Participant under the ISO Tariff. To the extent the CDWR is acting in its capacity under AB1X, it: (1) may not sell any power to retail End-Use Customers or to local publicly owned electric utilities at more than its acquisition costs [30] and (2) must strive to enter into contracts for Energy resulting in reliable service at the lowest

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[27] This letter and market notice are provided as Attachment D to this Answer.

[28] This letter is provided as Attachment E to this Answer.

[29] A copy of CDWR's signed letter authorizing release of the April 13 Market Notice is provided as Attachment F to this Answer.

[30] AB 1X at Section 80116.

possible price per kilowatt-hour.[31] Under AB1X , CDWR, like the ISO itself,[32] is to undertake its activities in the market in the public interest, and on behalf of others, without a profit motive. Under the ISO Tariff, a "Market Participant" is defined as "An entity, including a Scheduling Coordinator, who participates in the Energy marketplace through the buying, selling, transmission, or distribution of Energy or Ancillary Services into, out of, or through the ISO Controlled Grid." CDWR's purchase of Energy under AB1X does fall within that definition of "Market Participant." In Order No. 2000, however, the Commission has distinguished the activity of buying on behalf of others from the activities that bring an entity within the Commission's definition of a "market participant."[33] In addition, Order No. 2000 creates a presumption that an entity that merely makes *purchases* from a Regional Transmission Organization's (RTO's") markets is not within the Commission's definition of "market participant."[34]

The arrangements between the ISO and CDWR are intended to segregate the employees of CERS, the division of CDWR that financially backs and

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[31] AB1X at Section 80100.

[32] *See, e.g.*, Cal. Pub. Util. Code § 365(a) (West 2000); ISO Tariff, Section 2.2.1 ("In contracting for Ancillary Services and Imbalance Energy the ISO will not act as a principal but as agent for and on behalf of the relevant Scheduling Coordinators."); *Pacific Gas & Electric Company, et al.*, 81 FERC ¶ 61,122, at 61,496 (1997) ("The ISO should not be deemed to procure ancillary services on its own behalf since the ISO is not a participant in the market place. The ISO is appropriately securing the necessary ancillary services on behalf of Scheduling Coordinators since it is Scheduling Coordinators who will utilize these services.").

[33] Order No. 2000 has further found that market participant status will not arise from such activity even if it is performed by an entity other than the RTO. As long as this other entity is performing this action on behalf of the RTO's customers, this entity will not be considered a market participant. *Regional Transmission Organizations* (NOPR), FERC Stats. & Regs., 32,541 at 33,746, (1999). The Commission subsequently adopted this rule at Order No. 2000 at 31,141, 18 C.F.R. § 35.34(k)(4)(iii). Again, this is exactly the role that CDWR, in its capacity as CERS, performs in the current situation.

[34] Order No. 2000 at 31,061 (2000).

purchases on behalf of the retail customers of the California IOUs in accordance with AB1X, from the employees of CDWR that fulfill CDWR's more long-standing role of administering the State Water Project. Soon after the passage of SB7X, the ISO and CDWR entered into a "Confidentiality, Non-Disclosure and Use of Information Agreement." Copies of this Agreement (the "Confidentiality Agreement"), including all attachments and *addenda* thereto, are provided for the information of the Commission and all parties to this proceeding as Attachment G to this Answer.[35] This Confidentiality Agreement provides that all employees or contractors of CDWR that receive non-public information from the ISO are to be restricted from disclosing such information to any other person or entity, including those employees of CDWR that are not involved in implementing State legislation. The Confidentiality Agreement further provides that any employees or contractors of CDWR that receive non-public information from the ISO are not to be engaged in the "sales or marketing activities of CDWR." In order to ensure that each employee or contractor of CDWR that receives non-public information from the ISO is aware of their obligation to comply with the Confidentiality Agreement, these employees and contractors are each required to execute "Individual Agreements to be Bound By Non-Disclosure and Use of Information Agreement" indicating that they understand the terms of the Confidentiality Agreement and their obligation to comply with that agreement.

[35] The Confidentiality Agreement, by its terms, only applies for limited period, but has been extended until August 1, 2001 through four *addenda* executed by representatives of the ISO and CDWR. The ISO's provision of certain non-public information to CDWR is conditioned upon the continued effectiveness of the Confidentiality Agreement.

The Confidentiality Agreement is intended to protect against the potential for preferential treatment of market participants (*e.g.*, the sales and marketing arm of CDWR or third parties with commercial or economic interests in the electricity market) that the Commission's standards of conduct were designed to prevent. In light of the ISO's efforts to ensure that these protections are in place and in recognition of the fact that CDWR has indicated that it must have access to non-public information to fulfill its temporary, emergency role of purchasing and backing purchases on behalf of the customers of the California IOUs, the ISO reiterates its request that the Commission grant waiver of its standards of conduct to the extent the Commission may determine those standards apply.

D. The Commission's Credit Support Orders Do Not Relieve PG&E and Edison of Their Financial Responsibility for Energy and Services Procured On Behalf of Their Customers

In their comments on the May 11 Compliance Filing, PG&E and SoCal Edison claim that the Commission's orders on credit support in this proceeding require that they be relieved from all financial responsibility for Energy and services procured by the ISO on their behalf and to serve their retail customers. In other words, PG&E and SoCal Edison contend that the fact they no longer satisfy the creditworthiness provisions for Scheduling Coordinators and Utility Distribution Companies relieves them from all obligations under their Commission-approved contracts with the ISO, under the ISO Tariff, and under California State law. There is absolutely no basis for such an argument. Indeed, it would wreak further havoc on the California wholesale Energy markets if Utility Distribution Companies with End-Use Customers could be released from

contractual and statutory obligations simply for failing to maintain an Approved Credit Rating or to post security in accordance with their contractual obligations.[36]

It must be recalled that the ISO's initial filing of Amendment No. 36, which gave rise to this docket was intended to assist PG&E and SoCal Edison through what was hoped to be a short-term financial difficulty. Both PG&E and SoCal Edison supported Amendment No. 36.[37] The Commission's partial rejection of Amendment No. 36 and subsequent orders in this docket were at the behest of power suppliers who sought additional assurances of payment for energy and services provided on behalf of PG&E and SoCal Edison's End-Use Customers because PG&E and SoCal Edison had ceased to fulfill their financial and legal obligations.

Accordingly, the Commission's orders have been limited to addressing the need for a "creditworthy counterparty" or backer for transactions and deliveries of Energy made on behalf of PG&E and Edison. Thus the April 6 Order states that "[f]or transactions involving third-party suppliers," the Commission required "a creditworthy counterparty, such as the California Department of Water

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[36] The ISO notes that PG&E, in an adversary proceeding brought against the ISO in PG&E's Chapter 11 case, has raised before the United States Bankruptcy Court for the Northern District of California certain issues relating to the invoicing of PG&E for Energy and services procured on behalf of PG&E's End-Use Customers. The ISO believes that those issues are distinct from the issues addressed in the instant Answer.

[37] *See* Motion to Intervene of PG&E and Comments in Support of ISO Amendment No. 36 and Opposition to Motion of Reliant Energy for Cease and Desist Order, filed in Docket No. ER01-889-000 (January 1, 2001) at 1 ("PG&E urges the Commission to approve [Amendment No. 36] expeditiously."); SoCal Edison's Motion to Intervene, Request for Modifications of ISO Tariff Amendment No. 36 and Answer to the Motions Filed in Opposition to Amendment No. 36, filed in Docket No. ER01-889-000 (January 25, 2001) at 2 (asserting that "[t]he Amendment 36 proposal is the minimum measure necessary for Edison and PG&E to continue serving their customers").

Resources (DWR)."[38] More recently, the Commission again made it clear that its orders require only a creditworthy party to back purchases made on behalf of PG&E and SoCal Edison:

> Noting that the California Department of Water Resources (DWR) had begun making purchases on behalf of SoCal Edison and PG&E in the forward markets, the February 14 Order indicated that an agreement by DWR or a state bond to *back those utilities' liabilities* for third-party-supplied power could substitute for SoCal Edison and PG&E posting security.

June 13 Order, 95 FERC ¶ 61,391,slip op. at 3 (emphasis added) (footnotes omitted).

Nothing in those orders could be read as relieving PG&E and SoCal Edison of their responsibilities for Energy and services procured on their behalf, pursuant to the ISO Tariff and their contractual obligations to the ISO.

PG&E and SoCal Edison's liability for Energy and services procured on their behalf and on behalf of their customers is also mandated by California State law establishing that these utilities have the obligation to provide reliable electric service to their customers As noted above, AB1X, authorizes CDWR to purchase energy for the "net short" power requirements of PG&E and SoCal Edison, *i.e.*, the amount of power needed to serve the demand of the IOUs' customers less the power provided by generation owned or controlled by those utilities. Cal. Water Code § 80100 (West 2001). Under AB1X, the California Public Utilities Commission ("CPUC") is to determine the "net short " requirements - defined as that portion of existing retail rates that equals the

[38] April 6 Order, 95 FERC at 61,081

difference between the generation component of retail rates and the "sum of the costs of the utility's own generation, qualifying facility contracts, existing bilateral contracts, and ancillary services." Cal. Pub. Util. Code § 360.5 (West 2001). This portion of retail rates is known as the "California Procurement Adjustment" or "CPA." The CPUC is to determine that amount of the CPA that is allocable to the power sold by DWR and that amount that is "payable, *by each electrical corporation*, upon receipt by the electrical corporation of the revenues from *its retail end use customers*, to [CDWR] for deposit in the Department of Water Resources Electric Power Fund [i.e., the fund established to finance CDWR activities under the legislation]". *Id*. (emphasis added). The statute also explicitly provides that PG&E and SoCal Edison retain their primary responsibility to provide service to the customers in their service territory.[39] Thus, the other provisions of AB1X that indicate that retail end users are deemed to have purchased the power from CDWR, that payment for any sale is a direct obligation of the retail end user to CDWR, and that CDWR retains title to all power sold by it to retail end use customers[40] are properly understood as provisions that guarantee repayment to the CDWR Electric Power Fund and the taxpayers of California Fund. They do not indicate any intention to relieve the IOUs of their obligation to serve the Load in their respective service territories.

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[39] "Nothing in this division [of the Water Code] shall be construed to reduce or modify an electrical corporation's obligation to serve." Section 80002.5 provides that it is the intent of the Legislature that the power acquired by the Department under this division shall be sold to all retail end use customers *being served by the electrical corporations*. . . . " (emphasis added). Cal. Water Code § 80002 (West 2001).

[40] See Cal. Water Code §§ 80104 and 80110 (West 2001).

The CPUC recently reaffirmed the primary obligation of PG&E and SoCal Edison under California law to provide electric service to the customers in their service territories:

> AB1X continues the utilities' obligation to serve their customers. We cannot and will not relieve them of that fundamental statutory obligation. Further, although DWR has assumed responsibility to purchase some of the utilities' power requirements, it has not committed to purchase all net short power requirements. For the Commission to assume here, for the purpose of setting rates, that DWR will purchase all future net short electricity requirements would be the equivalent of ordering it to do so. Such an action would require authority the Commission does not possess. AB1X is permissive, not mandatory, with regard to DWR's authority to purchase power for utility customers' use.

CPUC Decision 01-03-082 at 14-15 (March 27, 2001). Thus, PG&E's claim that CDWR, and not PG&E, is obligated to serve the net short demand of PG&E's customers is contrary to the very state law that PG&E cites to support this assertion. PG&E and SoCal Edison remain financially responsible for Energy and services procured on their behalf under AB1X and that legislation provides a mechanism by which suppliers can receive payment for such services.

Finally, as noted earlier, PG&E and SoCal Edison's responsibility for Energy and services procured and their behalf arises not only from the ISO Tariff and state law but also from an interlocking mosaic of contracts that they have entered into with the ISO and that the Commission has approved as part of the restructuring of the California electric markets. These contracts include their Scheduling Coordinator Agreements, Utility Distribution Company Operating Agreements, the Transmission Control Agreement, various Meter Service

Agreements, and the Responsible Participating Transmission Owner Agreements. In order for PG&E and SoCal Edison to be relieved from these responsibilities, not only the ISO Tariff but also these agreements would need to be modified or terminated. Accomplishing this would require, at a minimum, the institution of complaint proceedings under Section 206 of the Federal Power Act. Moreover, it unclear how they could be relieved from these responsibilities without demolishing the foundations of the restructured California electric markets. Attractive as this prospect may be to some, PG&E and SoCal Edison have not initiated the appropriate steps to relive them of their liabilities or justified such a step.

In sum, there is no justification for PG&E and SoCal Edison's attempt to be relieved of responsibility for purchases and energy made on their behalf and behalf of their retail customers. The Commission should therefore disregard the comments of PG&E and SoCal Edison on this issue.

IV. CONCLUSION

For the foregoing reasons, the Commission should accept the ISO's May 11 Compliance Filing in this proceeding with only such modifications as are described above and, to the extent necessary, grant a limited exemption of its standards of conduct with respect to the ISO's provision of non-public information to CDWR.

Respectfully submitted,

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Dated: June 19, 2001

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, this 19th day of June, 2001.

_____

Sean A. Atkins
(202) 424-7500

June 19, 2001

The Honorable David P. Boergers
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Re: California Independent System Operator Corp.
Docket No. ER01-889-005

Dear Secretary Boergers:

Enclosed please find an original and fourteen copies of the Motion for Leave to Respond One Day Out-of-Time and Answer of the California Independent System Operator Corporation to Motions to Intervene, Comments, Motion for Leave to File Protest Out-of-Time, Conditional Protest, and Protests of the May 11, 2001 Compliance Filing in the above-captioned proceeding. Also enclosed are two extra copies of the filing to be date-stamped and returned to us by the messenger. Thank you for your assistance.

Respectfully submitted,

Sean A. Atkins

Counsel for the California
Independent System Operator Corporation