

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

California Independent System) Docket Nos. ER01-3013-000 and
Operator Corporation) ER01-889-008

COMPLIANCE REPORT

The California Independent System Operator Corporation (“ISO”)¹ respectfully submits five copies of this filing in compliance with the Commission’s November 7, 2001 “Order Granting Motion Concerning Creditworthiness Requirement And Rejecting Amendment 40” in the above-captioned dockets, (*California Independent System Operator Corporation*, 97 FERC ¶ 61,151) (“November 7 Order”). Specifically, this filing contains information on the amounts due the ISO markets resulting from benefits provided to customers in the service areas of the investor-owned utilities Pacific Gas and Electric Company (“PG&E”) and Southern California Edison Company (“SCE”) (collectively, the “IOUs”) and proposals for a schedule for payment by the California Department of Water Resources (“CDWR”) of those overdue amounts.² Also, in light of the Commission’s rejection of Amendment No. 40, in this filing the ISO submits proposals for the ISO’s re-initiation of its Dual Invoicing

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

² In accordance with the November 7 Order, the ISO has focused on compliance issues associated with ISO market transactions on behalf of PG&E and SCE. The ISO understands that CDWR also makes certain net short position purchases on behalf of San Diego Gas and Electric Company (“SDG&E”). The ISO will work with CDWR and SDG&E to coordinate appropriate invoice practices.

process as set forth in ISO Tariff Amendment No. 25.

I. BACKGROUND

A. Creditworthiness Requirements

The ISO Tariff imposes a creditworthiness requirement on Scheduling Coordinators, Utility Distribution Systems, and metered subsystems.³ Following reductions in the credit ratings for PG&E and SCE, in Docket No. ER01-889, the Commission required that the ISO provide assurances to third-party suppliers that a creditworthy party backed transactions for energy delivered against Loads throughout the ISO Control Area.⁴ The State of California (“State”), acting through the CDWR, agreed to serve as the creditworthy backer for ISO transactions on behalf of the IOUs beginning on January 17, 2001 and continuing to date. The ISO has filed with the Commission, in Docket No. ER01-889, a series of compliance filings, Market Notices and a Status Report, setting forth the agreements with CDWR to act as guarantor of certain transactions in ISO markets on behalf of the IOUs. On September 10, 2001, certain suppliers filed a Motion for Expedited Enforcement of the Creditworthiness Orders and Request for Shortened Response Period, which was granted by the November 7 Order.

³ See ISO Tariff Section 2.2.3.2.

⁴ 94 FERC ¶ 61,132(2001). In this February 14, 2001 Order, the Commission waived the ISO Tariff creditworthiness requirements as applied to generating resources owned by or under contract to PG&E and SCE to permit these IOUs to schedule such power against their own Load. The Commission also required that PG&E and SCE, neither possessing sufficient resources to self-supply their Loads, obtain a creditworthy party for their net short position, *i.e.*, power that is not self-supplied by each IOU respectively and accordingly is met through transactions with third-parties through the ISO markets. *See also*, 95 FERC ¶ 61,026, *reh'g denied*, 95 FERC ¶ 61,391, *reh'g denied*, 96 FERC ¶ 61,267 (2001).

The November 7 Order rejects the ISO's position that the CDWR served as a guarantor, or creditworthy backer, and not a Scheduling Coordinator, for the IOUs' net short positions.⁵ The ISO's understanding was that the IOUs served as Scheduling Coordinators for their respective net short positions, with CDWR acting as their agent, providing financial backing and making arrangements for power to serve their respective net short positions. The November 7 Order requires the ISO to treat CDWR directly as the Scheduling Coordinator for the IOUs net short positions, and subject to all applicable aspects of the ISO Tariff, and accordingly, to bill CDWR for "all ISO transactions it entered into on behalf of [SCE] and PG&E. . . ." November 7 Order, slip op. at 16.

B. Amendment No. 40

The ISO application for Tariff Amendment No. 40, filed in Docket No. ER01-3013, proposed a temporary change in the ISO's settlement practices as necessitated by the energy crisis in the California wholesale electricity markets. Specifically, the ISO, through Amendment No. 40, sought to modify its billing and settlement methodology, which, since June 2000, had included a Dual Invoicing process.⁶ Under the Dual Invoicing process, an initial payment is made to the Scheduling Coordinator based on Preliminary Settlement Statement Invoices and receipts received by the ISO in response to them, and final payment is made based on receipts received in response to the Final Settlement Statement

⁵ The "net short" position represents IOU Load not served by IOU generation.

⁶ The ISO employed a one-invoice settlement process prior to ISO Tariff Amendment No. 25, which established the Dual Invoicing process.

Invoice.⁷ As a result of Scheduling Coordinators defaulting on payments, market settlement recalculations creating major shifts in payments between the preliminary and final invoices, and netting by Scheduling Coordinators of payments owed for one month's transactions against amounts due for other transactions, certain Scheduling Coordinators who complied with the ISO Tariff by paying their preliminary invoices in full were short-paid on the final invoice when they were due refunds. To minimize this inequity, the ISO initiated a process whereby it issued a single monthly invoice and made a single payment distribution within five business days from the date the single invoice was issued. By rejecting Amendment No. 40 the Commission has required the ISO re-implement the Dual Invoicing process.

II. ISO Compliance

A. Introduction

The November 7 Order directs the ISO to revise its fundamental view of CDWR from that of creditworthy backer for transactions in ISO markets on behalf of the IOUs to Scheduling Coordinator for such transactions. Prior to November 7, the ISO, in compliance with the Commission's several orders in the creditworthy docket, ER01-889, dealt with the CDWR in CDWR's role as a creditworthy backer. The willingness of the State, acting through CDWR, to step into this role made it possible for the ISO to comply with the Commission's orders

⁷ The Commission has noted in numerous orders that the ISO is a revenue-neutral, not-for-profit entity. *See, e.g., California Independent System Operator Corp.*, 94 FERC ¶61,266 at 61,927-28 (2000). Both the original and the modified ISO market settlement procedures provide for the ISO simply to be the conduit for payments made and received in the various markets overseen by the ISO.

regarding financial backing for net short transactions in the ISO markets on behalf of the IOUs. The ISO made a series of filings indicating how the ISO was interacting with CDWR as the guarantor of IOU transactions. Now, in light of the Commission's requirement to deal with CDWR directly as the Scheduling Coordinator for the IOU net short position, the ISO, in compliance, has initiated several actions.

First, as described below, the ISO will bill CDWR as the Scheduling Coordinator for transactions in ISO markets on behalf of the IOUs' net short positions. Second, in the future, the ISO will send bills directly to CDWR for all costs applicable to transactions relating to the IOUs' net short positions. Third, the ISO will seek compliance by CDWR with applicable ISO Tariff requirements for scheduling, bidding, billing and settlement procedures and also will cease honoring CDWR's requests for access to non-public information not otherwise available to Scheduling Coordinators. Details of the ISO's plans in this regard are set forth below. Also detailed below are proposed processes for the ISO to re-initiate the Dual Invoicing process in compliance with the Commission's rejection of ISO Tariff Amendment No. 40.

B. Creditworthiness

1. CDWR Invoice For Past Due Amounts

The November 7 Order specifically directs the ISO to apply its billing and settlement procedures under its Tariff to CDWR. The Commission found that CDWR serves as a Scheduling Coordinator not only for the State

Water Project, but also for the IOUs' net short positions. As a Scheduling Coordinator, the Commission stated CDWR has:

an obligation [] to abide by and perform all of the obligations under the ISO Tariff, without limitation. This includes an obligation to pay for scheduled and unscheduled transactions made on the Scheduling Coordinator's behalf by the ISO.. . . Therefore, because DWR has assumed responsibility for purchases by the ISO, and because DWR functions as a Scheduling Coordinator for this net short position of PG&E and [SCE], DWR must abide by the requirements of the ISO Tariff and the Scheduling Coordinator Agreement.. . . The ISO is obligated under its Tariff to invoice, collect payments from and distribute payments to DWR, as the Scheduling Coordinator for all scheduled and unscheduled transactions made on behalf of DWR, including transactions where DWR serves as the creditworthy counterparty for the applicable portion of PG&E's and [SCE]'s load.

November 7 Order, slip op. at 13 – 14.

By these findings the Commission rejected the ISO's assertion that CDWR acts as an agent for the IOUs, merely procuring power from third-parties that the IOUs themselves schedule with the ISO. The Commission also now has made clear that even where CDWR acts as the creditworthy backer of transactions in the ISO's Imbalance Energy Market, the ISO is to treat CDWR as a Scheduling Coordinator for these Loads. Additionally, the Commission notes that CDWR:

does not have unilateral discretion to determine the rates for purchases it makes on behalf of PG&E and [SCE] and instead must accept and pay the rates set by this Commission. If DWR disagrees with these rates, it may challenge the rates through an appropriate filing with the Commission. Neither DWR nor any other party should be engaging in the types of self-help described in this proceeding. *Id.* at 15.

Based upon the Commission's determination that CDWR is a Scheduling Coordinator for purchases it makes on behalf of PG&E and SCE net short positions, the ISO is directed to invoice CDWR "for all ISO transactions it entered into on behalf of [SCE] and PG&E within 15 days from the date of this order." *Id.* at 16. The ISO also is required to file a report with the Commission indicating "overdue amounts from [CDWR] and a schedule for payment of those overdue amounts within 3 months of the date of this order." *Id.*

Accordingly, in compliance with the November 7 Order, the ISO on this date has invoiced CDWR for the full range of charges allocated to all Scheduling Coordinators, including, but not limited to, charges for Ancillary Services, Day-Ahead and Hour-Ahead Inter-zonal Congestion, Instructed Energy, Uninstructed Energy and Neutrality. While the November 7 Order has directed the ISO to invoice CDWR for transactions on behalf of the IOUs' net short positions, the Commission may have inadvertently overlooked certain nuances of the ISO settlement and billing process regarding receipt of billing information from Scheduling Coordinators and how the ISO must prepare statements and invoices.

Specifically, to invoice CDWR for the IOUs' net short position only, the ISO must have meter data and schedules for Load to serve such net short positions. To date, the ISO only receives meter data and schedules from the IOUs, and these data and schedules are not differentiated between Load served by the IOUs' retained generation resources and Load served by CDWR in support of the IOUs' net short positions. As a result, the ISO can only invoice

CDWR for the entire unpaid amounts of all ISO market transactions on behalf of the IOUs. Upon receipt from CDWR and/or the IOUs of data specific to the IOUs' net short positions, the ISO can prepare invoices tailored to such transactions only.

The ISO has invoiced CDWR, as described above, for the period of January 17 through July 31, 2001. The ISO invoice for the month of August 2001, has already been sent, consistent with ISO practices prior to the November 7 Order, to PG&E and SCE, and pursuant to the billing and settlement calendar set forth in the ISO Tariff, the months of September and forward are not yet ready to be invoiced and settled. Such forward months are not in arrears and thus the ISO proposes to settle amounts due to the ISO and ISO Market Participants for September forward in a manner consistent with ISO Tariff provisions for billing and settlement with Scheduling Coordinators.

The invoices that the ISO provided to CDWR for the past due amounts are based upon the invoices for the relevant period that the ISO previously provided to PG&E and SCE (the "CDWR Invoice"). For the period of January 17 through July 31, 2001, the overdue amounts due from CDWR, when netted against amounts owed by the ISO markets to CDWR, is equal to \$955,699,762.10 as detailed in the CDWR Invoice, appended hereto in Appendix A.

2. Payment Schedule For CDWR Past Due Amounts

The November 7 Order also requires the ISO to file with the Commission a schedule for payment by CDWR of overdue amounts. In Appendix B the ISO provides two (2) alternative schedules for payments by

CDWR to the ISO of the overdue amounts. Both schedules commence with the ISO providing CDWR with a set of invoices for the past due amounts from the period of January 17 through July 31, 2001. The ISO delivered these invoices to CDWR on November 20, 2001. The month of January necessarily must be divided into two parts because amounts due to the ISO and Market Participants arising from IOU-related transactions on January 1 through January 16, 2001 were incurred before enactment of California legislation authorizing CDWR to cover the IOUs' net short positions, while payments for all such transactions occurring on and after January 17, 2001 followed enactment of the authorizing legislation. To provide ISO staff sufficient time to perform accurately the considerable settlement work to separate transactions for the month of January into the two parts, both schedules begin with CDWR payments for the month of February, advance through July and then schedule a payment to the ISO for the split month of January.

Schedule No. 1 provides for a fifteen (15) day lag between ISO providing CDWR with invoices on November 20 and the due date for the first payment to the ISO, to accommodate time needed for CDWR to make necessary arrangements with other State agencies and offices, especially including the State Comptroller, for access to funds to pay the invoiced amounts. Thus, Schedule No. 1 provides for CDWR to pay to the ISO past due amounts for February 2001 on December 6, 2001. The ISO will disburse those funds to Market Participants on December 13, 2001. Schedule No. 1 then advances

through the invoicing and payment dates for each month with completion of all disbursements of past due amounts on February 7, 2002.

As noted in greater detail below, the November 7 Order also directed the ISO to re-implement a Dual Invoicing process. The ISO will require a certain amount of preparatory work for such a re-implementation and such work necessarily falls upon the same limited resources in the ISO settlements, finance and accounting departments. The ISO does not believe it can accurately implement both an immediate return to a Dual Invoicing process and a three-month schedule for collection and disbursement of CDWR past due amounts. Given that the most important issue at hand is getting money back into the ISO markets as quickly as possible, the ISO's Schedule No. 1 reflects a priority on settling past due accounts with CDWR first, then re-implementing the Dual Invoicing process. Accordingly, the ISO provides, in Schedule No. 1, for expedited payments to Market Participants over the next three months and re-implementation of the Dual Invoicing process beginning with the November, 2001 Preliminary Invoice to be sent out on January 29, 2002. The ISO recommends adoption of Schedule No. 1.

In the alternative, if the Commission determines that the ISO should undertake re-implementation of the Dual Invoicing process immediately, the ISO proposes to implement alternative Schedule No. 2, which provides for an immediate return to the Dual Invoicing process. Specifically, as set forth in Appendix B, Schedule No. 2 provides for CDWR payment to the ISO for the February, 2001, account on December 6, 2001 and the ISO disbursing such

monies on December 13, 2001. This Schedule No. 2 specifically provides for the ISO to re-implement a Dual Invoicing process beginning with an October 2001 Preliminary Invoice on December 27, 2001.

The ISO believes that it is of paramount importance to settle the past due CDWR amounts and distribute such funds to Market Participants. While not diminishing the importance of the Commission's order for the ISO to re-implement a Dual Invoicing process, the ISO notes that it is the same small ISO professional staff that must work quickly and accurately to settle the CDWR accounts over the next three months as well as prepare and re-implement the Dual Invoicing process. The ISO proposes to the Commission that a short sequencing of the two actions, with immediate settlement of CDWR accounts and re-implementation of the Dual Invoicing process towards the end of the three month period, is the most efficient and effective solution to compliance with the two directives.

C. ISO Billing And Settlement Procedures

The Commission found that CDWR, as a Scheduling Coordinator subject to, among other things, the settlement and billing procedures of the ISO Tariff, "shall discharge its payment obligations and likewise, receive all payments owed to it under the ISO Tariff *only through the ISO.*" November 7 Order, slip op. at 13. Emphasis in original. The Commission also directed the ISO to file a schedule for CDWR payment over three months of overdue amounts accrued over some six and one-half months (i.e., January 17 through July 31, 2001). Moreover, the Commission also directed the ISO to "enforce its billing and

settlement procedures under its Tariff. . .” November 7 Order, slip op. at 15. Thus, the Commission directed the ISO to (1) create a billing and settlement process that would, within three months provide for settlement of some six and one-half months worth of past due accounts (such a schedule is not provided for in the ISO Tariff); (2) settle CDWR accounts through the ISO and subject to the ISO Tariff; and (3) enforce its billing and settlement procedures under the ISO Tariff.

As detailed below, billing and settlement of the January 17 through July 31, 2001, past due amounts must, of necessity, be accomplished through a slightly modified settlement process in accordance with the three month period. Thus, the ISO requests leave to deviate from one ISO Tariff provision for this unusual, one-time settlement of the CDWR amounts owed and owing for the period of January 17 through July 31, 2001, inclusive.

Payments for the month of August, 2001 are not overdue of the date of this filing. Therefore, the ISO proposes to defer settling August, already invoiced to the IOUs, by billing to CDWR any unpaid amounts due with regard to such month after February 7, 2002, i.e., after the ISO has completed settlement of the January 17 through July 31, 2001 CDWR account. Moreover, beginning with the statement for September 2001, the ISO will invoice CDWR directly for amounts due as a result of transactions on behalf of the IOUs.

Therefore, for the period of January 17 through July 31, 2001 only, specifically, to accomplish an expedited schedule for settlement of CDWR past

due amounts, the ISO proposes the following procedures, which in one particular, deviate from the ISO Tariff:

- (i) Payments made by CDWR shall first be applied to the month remitted as indicated by the CDWR in their payment remittance (e.g., CDWR June 2001 payment is applied to the CDWR June 2001 invoice). The ISO Tariff, Settlements and Billing Protocol, Section 6.10.4, would have the ISO apply any given monthly payment to earliest unpaid balances. The ISO proposes this modification to the billing and settlement procedures set forth in the ISO Tariff to ensure that CDWR funds are not applied to debts accrued prior to enactment of legislation authorizing CDWR to cover the IOUs' net short positions.
- (ii) Settlements with CDWR will commence with February instead of January (as explained above, disbursements for January will be complex because the month is split into parts). The ISO Tariff does not specifically provide for such an "out-of-sequence" settlement calendar.
- (iii) Any surplus of funds remaining after all creditors in a given month are paid in full from a CDWR payment for that month, shall be held in a reserve account and applied to unpaid creditors starting with February 2001 and going forward through the month of July and then applied to January, 2001. The ISO Tariff is silent as to the month or order for application of surplus funds.
- (iv) Offsets due to credits for any month in which that creditor is also a debtor for any month prior to January 2001 shall be held in a reserve

account and applied to unpaid creditors starting with February 2001 and going forward through the month of July and then applied to January 2001 (as described in iii above). The ISO Tariff, Settlements and Billing Protocol, Section 6.10.4, would require the ISO to apply any given monthly payment to the earliest unpaid balances.

The November 7 Order, in directing the ISO to undertake an expedited billing and settlement process to clear the overdue accounts, has challenged the ISO to rapidly perform a complex market clearing that is critically important to resolving serious problems in ISO markets. The ISO has engaged its independent accountants to review the allocation of proceeds received from CDWR and disbursed to ISO Market Participants. The accountants will report their findings in the form of an assurance report to be filed with the Commission and made available to the public on request.

D. Amendment No. 40

As noted above, re-implementation of a Dual Invoicing process will require a certain amount of time that necessarily will reduce the ISO staff resources that otherwise would work on settlement of the past due amounts. Also as set forth above, the ISO has developed two alternative schedules for settling the past due amounts and re-implementation of a Dual Invoicing process. Balancing the merits of immediate implementation of a Dual Invoicing process against the universal desire to infuse money into the ISO markets and settle overdue accounts would appear to favor delaying the ISO's return to a Dual Invoicing

process in favor of a more rapid distribution of past due amounts to Market Participants.

In the event that the Commission does not permit the ISO to re-implement the Dual Invoicing process as set forth in Schedule No. 1, the ISO requests the Commission accept Schedule No. 2, which seeks to balance a more timely return to a Dual Invoicing process with a concomitant and unavoidable slippage in the completion of disbursement of all past due amounts from February 7 to February 28, 2002.

The finite ISO settlement, finance and accounting department resources obliges the ISO respectfully to seek relief from the several complex and resource-intensive tasks the Commission is requiring of the ISO in a very short time. Thus, the ISO proposes to: (i) settle, within three months the past amounts for the period of January 17 through July 31, 2001, (ii) re-implement a Dual Invoicing process beginning with a November, 2001 Preliminary Invoice on January 29, 2002, (iii) settle unpaid amounts from the August, 2001, which were originally invoiced to the IOUs, through a "re-invoicing" to CDWR, and (iv) settlement of September and October, 2001, through a single invoice sent to CDWR.

III. Supporting Documents

The following documents, in addition to this letter, support this filing:

Appendix A: CDWR Invoice

Appendix B: Schedule No. 1

Schedule No. 2

Appendix C: Notice of filing

Two addition copies of this filing are enclosed. Please stamp these with the time and date of filing and return them with our messenger. If there are any questions concerning this filing, please contact the undersigned.

Respectfully submitted,

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