

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

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

**Status Report of the California Independent System Operator Corporation
Regarding Creditworthy Counter-Parties For Third-Party Suppliers**

I. Introduction

Pursuant to Rules 207 and 215 of the Rules of Practice and Procedures of the Federal Energy Regulatory Commission (“Commission”), 18 C.F.R. §§ 385.207 and 385.215, the California Independent System Operator Corporation (“ISO”)¹ hereby files a status report on its compliance with the Commission’s February 14 and April 6 Orders² regarding creditworthy counterparties for third-party supplier transactions in the above-referenced proceeding. The ISO also herein renews its request that the ISO’s provision of certain nonpublic information to the California Department of Water Resources (“CDWR”) in response to that entity’s demands made as a condition of its role as a creditworthy backer, and as first set forth in the ISO’s May 11, 2001 compliance and request for waiver filing, be deemed by the Commission as outside of the Commission’s standards of conduct regulation as set forth in 18 C.F.R., Part 37,

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 *California Independent System Operator Corporation, et al.*, 94 FERC ¶¶61,132 (2001) (“February 14 Order”) and *California Independent System Operator Corporation, et al.*, 95 FERC ¶¶61, 024 (2001) (“April 6 Order”).

or in the alternative, that the Commission grant to the ISO an exemption for any otherwise application restrictions.

II. Communications

Please address communications concerning this filing to the following:

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III. Background

In response to the deteriorating financial condition of California's investor-owned utilities ("IOUs") Southern California Edison Company ("Edison") and Pacific Gas and Electric Company ("PG&E"), and inevitable downgrade in credit ratings for those IOUs, the ISO filed proposed ISO Tariff Amendment 36 with the Commission on January 4, 2001. Amendment 36 would, in effect, waive the sanctions of the ISO Tariff's creditworthiness requirements (loss of the opportunity to submit Schedules) for Edison and PG&E, and thus would have allowed these IOUs to continue to schedule Generation and Demand despite the loss of their Approved Credit Rating, and thereby allow these IOUs to continue to provide electricity to California's retail End-Use Customers.

On January 21, 2001, the ISO provided by electronic mail to Market Participants a Market Notice ("January 21 Market Notice"), appended hereto in Appendix A, setting forth terms of agreement between the ISO and CDWR to facilitate CDWR's purchase of electricity for the benefit of retail electricity

customers of the IOUs that became effective at 12:01 a.m. that day. The Market Notice describes the process by which CDWR agreed to enter into bilateral transactions to procure power that (1) the IOUs are not able to self-provide (i.e., the “net short” position or the difference between an IOU’s retained Generation and Load) and (2) are needed by the ISO for balancing adjustments rising from changing Load requirements in the IOU Service Areas. CDWR agreed to purchase power for the ISO’s Real Time Market and confirmed that it, in accordance with California legislation SB7X,³ is making purchases in the ISO’s Real Time Market to meet the retail Load requirements of the IOUs.

In its February 14 Order, 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 but barred the ISO from waiving this requirement for transactions involving third-party suppliers. Specifically, Amendment 36 proposed to waive the limitations set forth in Section 2.2.7.3 of the ISO Tariff on the ISO’s ability to receive forward schedules from Scheduling Coordinators that are temporarily unable to satisfy the creditworthiness provisions in its Tariff. The Commission stated that it would allow the ISO to excuse the IOUs from posting security for third-party transactions only if appropriate substitute credit-support arrangements were made for such transactions. The Commission indicated that an agreement with the CDWR or state appropriations to back the IOUs’ liabilities for third-party-supplied power could substitute for the IOUs’ posting of such security.

³ Later CDWR affirmed that, pursuant to AB1X, it is purchasing power supplied to the ISO’s Real Time market to meet the Loads of the IOUs.

On March 1, 2001, in response to the February 14 Order, the ISO filed revisions to the creditworthiness provisions in the ISO Tariff. Subsequently, in its April 6 Order, the Commission directed the ISO to ensure the presence of a creditworthy counterparty for all Energy that third-party suppliers provide to the IOUs, including Energy provided through real-time transactions. Thus the Commission required 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.

On April 13, 2001, the ISO issued a Market Notice ("April 13 Market Notice"), appended hereto in Appendix B, explaining how the ISO would comply with the April 6 Order. Included in the April 13 Market Notice is a statement explicitly agreed to by CDWR that, to the extent a purchase is not otherwise paid or payable by a Qualified Party, CDWR will assume financial responsibility for "all purchases by the ISO in its ancillary services and imbalance energy markets based on bids or other offers determined to be reasonable." Id. In approving the April 13 Market Notice, CDWR agreed that it was the financially responsible party, if no other Qualified Party was available, for (1) all ISO purchases in its Ancillary Services and Imbalance Energy Markets based on bids or other offers determined by CDWR to be reasonable and (2) all purchases resulting from ISO Dispatch Instructions issued during ISO-declared System Emergencies, to the extent not paid or payable by another Qualified Party and payable at the rate specified in the ISO Tariff. Accordingly, the ISO noted in the April 13 Market

Notice its belief that the arrangements with CDWR met the April 6 Order requirements.

By letter order dated April 26, 2001, the Commission informed the ISO that its March 1, 2001 compliance filing was deficient and required that certain modifications to the Tariff creditworthiness provisions be filed with the Commission. The Commission, among other things, directed that the ISO amend its March 1, 2001 compliance filing to ensure that the CDWR is afforded the same non-preferential treatment as other Market Participants, especially other electricity purchasers.

In compliance with the letter order of April 26, in its May 11, 2001, compliance and waiver request filing ("May 11 Compliance Filing and Waiver Request"), appended hereto in Appendix C, the ISO filed additional revisions to its Tariff to provide for non-preferential treatment for CDWR. The ISO also affirmed that CDWR accepted the responsibility of providing credit support for purchases in the ISO's Ancillary Services and Imbalance Energy Markets on behalf of the IOUs, noting that "only one party – DWR—has stepped forward to provide the credit support required by the Commission as a condition to meeting the emergency needs of California consumers." Id. at 1.

Additionally, the ISO stated that

DWR has also indicated a willingness to back certain transactions in real-time. However, in discharge of this latter responsibility, and its fiduciary obligation to conserve the finite financial resources that have been placed at its disposal, DWR has advised that it must access to the ISO control room floor and to a limited amount of nonpublic information. DWR has further advised that these requirements are a necessary condition to its continued provision of credit support.

Id. at 1-2.

Accordingly, in the May 11 Compliance Filing and Waiver Request, the ISO recognized that absent CDWR's willingness to "step into this unique financial assurance role, the ISO would have absolutely no ability, in light of the [credit requirements] to discharge its fundamental reliability responsibility, a responsibility that the Commission has acknowledged is at the core of the ISO's mandate." Id. at 2. The ISO requested the Commission to deem that CDWR's requirements for access to the ISO Control Center and to certain nonpublic information as being outside the circumstances covered by the Commission's standards of conduct regulations, 18 C.F.R., Part 37. The ISO also requested that to the extent the Commission disagreed that CDWR's request should be so deemed, that the Commission grant an exemption in favor of the ISO and CDWR with regard to otherwise applicable restrictions. Id.

On May 25, 2001, the ISO posted a Supplemental Market Notice ("May 25 Supplemental Market Notice"), appended hereto in Appendix D, providing that, absent the ability of the ISO to provide reasonable assurances that a party meeting the ISO's credit requirements will support a specific transaction, the ISO

would not enter into transactions for awarding capacity bids in the forward Ancillary Services markets and dispatching Imbalance Energy bids in the Real Time Market above prices for which CDWR has agreed to provide credit backing.

The ISO also noted in the May 25 Supplemental Market Notice that “Imbalance Energy bids above the prices for which CDWR has agreed to provide credit backing, though not accepted, shall remain in the “BEEP” stack.⁴ Accordingly, in accordance with ISO Tariff §§5.13 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.”

Now, given the passage of time and continuing role of CDWR as the sole creditworthy backer for third-party transactions in ISO markets,⁵ the ISO undertakes in the instant filing to inform the Commission of the ISO’s current compliance status regarding assurances of creditworthy backers of ISO transactions in ISO’s Ancillary Services and Real Time Markets. The ISO also informs the Commission of the continuing requirements placed upon the ISO by CDWR for access to nonpublic information and renews its previous request that the CDWR demands be deemed to be outside the Commission’s standards of conduct or, in the alternative, that the Commission grant an exemption to applicable regulations.

⁴ The ISO's Balancing Energy Ex Post Price stack of real-time Imbalance Energy bids.

⁵ The ISO also undertakes this filing in response to concerns expressed to the ISO by Market Participants and because, at a FERC staff meeting on September 24 – 25, 2001, held at

IV. Discussion

A. Type of Transactions Receiving CDWR Credit Backing

From January 19, 2001 to the present, as detailed above, CDWR has provided certain information about which products and services it will back. Prior to the instant filing, CDWR, as documented in the Market Notices detailed above, provided to the ISO, and Market Participants, general descriptions of the types of products and services, both Energy and capacity, it would procure on behalf of the IOUs' retail electricity consumers in California. In preparation of this filing, the ISO has now received from CDWR a definitive listing of ISO Settlement Charge Types ("CTs") that CDWR will back. Set forth in the table below are the ISO Settlement CTs for all of the Energy and capacity transactions that CDWR has indicated it will financially back, along with CDWR imposed restrictions on any such credit backing. The CDWR has informed the ISO that its credit backing, subject to the restrictions set forth below, is limited to these CTs and no others at this time.⁶

the ISO, both the ISO and CDWR committed to making public which Energy costs CDWR is or is not backing as the requisite creditworthy backer.

Table 1: Limitations to CDWR Credit Backing of Third-Party Supplier Transactions in the ISO Ancillary Services and Imbalance Energy Markets

Energy Type	Period	ISO CT	Restrictions
Incremental Instructed Energy	January 19 – April 5, 2001	401	Bid at or below applicable FERC proxy price
Excess Cost for Instructed Energy	January 19 – April 5, 2001	481	Portion of bid found equal to or below FERC just and reasonable rates in excess of ISO MCP
Incremental Instructed Energy	April 6, 2001 To Present	401	Bid at or below CDWR approved price
Excess Cost for Instructed Energy	April 6, 2001 To Present	481	Portion of bid in excess of ISO MCP at or below CDWR approved price
Ancillary Services (spin, non-spin, replacement reserve capacity, regulation)	April 6, 2001 To Present	1,2,3,4,5, 6, 51, 52, 53,54,55, 56	Bid at or below CDWR approved price
Uninstructed Energy	June 19, 2001 To Present	407	Considering payments for minimum loading of Generators pursuant to FERC must-offer obligation as implemented by ISO

Based upon the several public written assurances made by CDWR regarding its financial backing of ISO transactions in ISO Ancillary Services and Imbalance Energy Markets made to meet Load requirements of the IOUs, the ISO believes that it has been and currently is in compliance with the Commission's orders.

B. Third-Party Supplier Concerns Lie With Delay In Payment

The ISO believes that concerns raised by suppliers to date arise not from the lack of a creditworthy party, but from delay in payment. The delay in payment derives from the absence of an agreed-upon mechanism by which CDWR - who, although akin to a guarantor, is not the debtor under ISO settlement procedures – can make payments on behalf of the IOUs. This delay

⁶ The ISO is almost without influence or ability to cause CDWR to expand its credit backing to a greater number of Energy and capacity products and services (and by inference, a greater number of ISO Settlement CTs).

in payment has nothing to do with the ISO's compliance with the Commission's orders on creditworthiness.

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 receives amounts paid by Scheduling Coordinator debtors and distributes such amounts to Scheduling Coordinator creditors. Ancillary Services and Imbalance Energy costs are billed to the Scheduling Coordinator for the responsible Load. These settlement provisions were not initially drafted to accommodate third-party guarantors, and thus the ISO is obligated to invoice the IOUs for the purchases backed by CDWR. Therefore, although CDWR has agreed to provide credit backing for purchases on behalf of the IOUs, the mechanism by which CDWR is to make necessary payments to third-party suppliers remains to be developed.

These complications notwithstanding, the ISO has remained in compliance with the ISO Tariff provisions regarding the ISO role as settlement agent. Under the ISO Tariff, the ISO bills the IOUs – the Scheduling Coordinators- for Ancillary Services and Imbalance Energy procured on behalf of their Loads. The ISO, however, is only authorized and required to distribute amounts in its Clearing Account and Reserve Account, i.e., amounts it actually has received from Debtors or as security deposits. The ISO Tariff does not require the ISO to act as a collection agent. The ISO Tariff requires the ISO to ensure that Scheduling Coordinators are creditworthy, or, pursuant to Commission orders, to provide assurances of payment from a creditworthy third-

party for transactions on behalf of the IOUs in the ISO Ancillary Services and Imbalance Energy Markets. The ISO Tariff does not require the ISO itself to become a guarantor and ensure that the CDWR, or any other creditworthy party, abides by their payment obligations. Nothing in the Commission's orders requires to the contrary.

C. CDWR Demands for Nonpublic Information

As noted above, CDWR has conditioned its role as credit backer on receipt of nonpublic information and access to the ISO Control Center. The Commission is advised that, as of noon on September 1, 2001, CDWR no longer was permitted access to the ISO Control Center. However, CDWR continues to require the ISO to supply it with certain nonpublic information not otherwise available to Market Participants.

For example, CDWR is requiring, as a condition of its creditworthy backer role, that the ISO supply it with hourly information, in \$10/MWh increments, as to the amount of Energy available in the "BEEP" stack. These data are not made available to other Market Participants. The CDWR also requires the ISO to notify it about supply, demand, congestion and other types of changes in the ISO system in advance of such notification to other Market Participants.

CDWR also requires time-sensitive information regarding the ISO's forecasted net shortage of Generation for the upcoming operating hour. Such information is not made available to other Market Participants. The ISO is further required to accept and dispatch out-of-market ("OOM") bids acquired by CDWR in advance of other bids in the "BEEP" stack. A draft operating procedure

summarizing this OOM information exchange with CDWR is posted on the ISO Home Page.

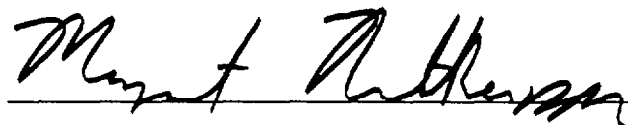
In a recent agreement between the ISO to CDWR, the “IOU Invoicing and BEEP/AS Payment Procedure” dated September 14, 2001 (“ISO-CDWR Payment Process”), posted on the ISO Home Page and attached hereto in Appendix E, CDWR has conditioned its payment to suppliers for CTs based on the ISO providing to CDWR verification of such suppliers’ Generating Unit-specific costs, quantities supplied and time intervals of the transactions. Id. at 2.⁷ Under the ISO Tariff, such supplier-specific data ordinarily cannot be made available to any third party absent consent from the relevant supplier. CDWR asserts that its requirements are necessary to satisfy obligations under State law. CDWR maintains that its review of data on specific transactions and a determination that those transactions were just and reasonable is necessary to assure the lowest cost for consumers. The CDWR can only perform such a “prudency review” of ISO charges via access to confidential supplier-specific data, which may only come to the CDWR through the supplier entering into a confidentiality agreements (part of a “supplier settlement”) with CDWR or by the supplier authorizing the ISO to provide to CDWR the supplier’s confidential data. It is not certain that suppliers will enter into such supplier settlements or grant permission to the ISO to give their data to CDWR.

The above-described ongoing requirements for nonpublic information

⁷ The text refers to “netting of BEEP/AS” which is defined on page 1 to mean the portion of AS (Ancillary Services) and Real Time Energy (Instructed Imbalance Energy, Instructed Supplemental Energy and Uninstructed Imbalance Energy to the extent (but only to the extent) associated with the provision of Regulation, other than OOM.

place the ISO in a difficult position. To the extent that the ISO must continue to fulfill its obligation to ensure reliable electric service to the IOUs' retail End-Use Customers, the ISO considers it has little choice but to comply with the need and requirements of its only creditworthy backer. The ISO urges understanding and forbearance on the Commission's part inasmuch as the circumstances giving rise to the ISO's present position are outside the control and influence of the ISO. To the extent the ISO requires exemption from Commission regulations bearing upon the above-detailed arrangements with CDWR, the ISO requests such exemption.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Margaret A. Rostker", is written over a horizontal line.

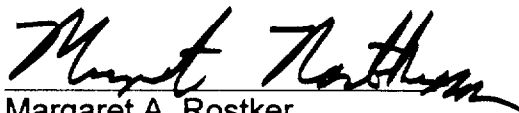
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Dated: October 12, 2001

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 via U.S. mail.

Dated at Folsom, California, this 12th day of October, 2001.



Margaret A. Rostker
Counsel for The California
Independent System
Operator Corporation