UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	**)** **)**	**Docket No. ER01-889-006**
San Diego Gas & Electric Company, *et al.*	**)** **)**	**Docket No. EL00-95-036**

ANSWER OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION TO MOTION FOR ENFORCEMENT OF THE ORDERS OF THE FEDERAL ENERGY REGULATORY COMMISSION OF SOUTHERN CALIFORNIA EDISON COMPANY

Pursuant to Rule 213 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213, the California Independent System Operator Corporation ("ISO")[1] files this Answer to the Motion for Enforcement of the Orders of the Federal Energy Regulatory Commission ("Motion") filed by Southern California Edison Company ("Edison") in the above-captioned dockets. In its Motion, filed June 7, 2001, Edison requests that the Commission enforce its orders regarding creditworthiness standards, and require the ISO to "cease its attempts to assign Edison the financial responsibility for the costs incurred by the ISO in transactions with third-party suppliers". Motion at 1. As explained below, the relief requested by Edison is unnecessary as the ISO in fact is in compliance with the Commission's orders.

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

I. BACKGROUND

The creditworthiness issue arose at the time that the ISO filed Amendment No. 36 in Docket No. ER01-889 on January 4, 2001, after it became apparent that the financial well-being of 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 Edison and PG&E as a Scheduling Coordinator (and whose financial well-being in this capacity was linked to that of Edison 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 posted financial security in accordance with Section 2.2.3.2. Due to their financial status, it was similarly apparent that Edison, PG&E, and the PX also would be 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,"[2] in which it conditionally

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

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.

On March 1, 2001, the ISO filed a compliance filing as directed by the Commission in the February 14 Order. In that filing, 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 an order issued on April 6, 2001,[3] the Commission declared that the ISO had misinterpreted its February 14 Order. The Commission stated that the

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

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," including unscheduled Energy purchased in the ISO's real-time Imbalance Energy market. 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.[4]

In its compliance filing of May 11, the ISO advised the Commission that the California Department of Water Resources ("DWR") 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 Edison and PG&E that is not satisfied by Generation that these entities own or control, including Generation under contract. Absent DWR's willingness to step in to provide the financial assurance required by the

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Order").

[4] 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").

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.

The ISO previously had 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 credit support issues in response to a motion for clarification filed the

Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California ("Southern Cities").[5] In that order,[6] 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 through purchases by DWR (or another creditworthy counterparty) on their loads' behalf." June 13 Order, 95 FERC ¶ 61,391, slip op. at 11.

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[5] 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 suppliers providing Energy under the Commission's "must-offer" requirement, the very issue on which Southern Cities sought clarification.

[6] *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*

II. EDISON'S MOTION

In the instant Motion, Edison requests that the Commission enforce its orders regarding creditworthiness standards, and require the ISO to "cease its attempts to assign Edison the financial responsibility for the costs incurred by the ISO in transactions with third-party suppliers". Motion at 1.

The relief requested by Edison is unnecessary. In fact, as described above, the ISO already complies with the requirements of the Commission's orders on creditworthiness.

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

At the start of this year, DWR was authorized to contract for, and back the purchases of Energy, on behalf of the customers of California Investor-Owned Utilities ("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 over a year. Senate Bill 7X ("SB7X"), signed by the Governor on January 18, 2001, allowed DWR 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 DWR to purchase energy for the "net short" power requirements of the IOUs. The "net short" requirement is the

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Exchange, et al., 95 FERC ¶ 61,275 ("May 25 Order").

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.[7]

The ISO has provided the Commission with evidence of its compliance with those orders. Specifically, the ISO has provided the Commission with a Declaration of Mr. James W. Detmers, the ISO's Vice President of Grid Operations, which was filed in the Bankruptcy proceeding involving PG&E. In that declaration, a copy of which is provided as Attachment D to this answer, Mr. Detmers states that, since the issuance of the April 6 Order, the ISO has "not entered into any real time transaction unless a creditworthy party has provided assurances of payment."

Edison contends that since it no longer meets the creditworthiness requirements of the ISO Tariff, the ISO should "direct [its] invoices for payment to an appropriate creditworthy entity, such as CDWR." Motion at 6. Apparently, Edison would like to convert the Commission's directives that the ISO "obtain prior assurances of payment for all third-party power *supplied to Edison* and PG&E, whether directly or through purchases by DWR (or another creditworthy counterparty) on their loads' behalf"[8] into a requirement that DWR (or possibly another "appropriate entity") directly assume Edison's responsibilities as a Scheduling Coordinator. As the language quoted above indicates, however, the creditworthiness requirements prescribed by the Commission are satisfied when

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[7] 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.

[8] June 13 Order, 95 FERC ¶ 61,391, slip op. at 11 (emphasis added).

the ISO obtains "prior assurances of payment for . . . third party power supplied to Edison." This does not require the ISO to redirect the invoices associated with Edison's failure to secure enough Generation to meet the Demand that it schedules. Rather, it requires only that the ISO obtain DWR's prior commitment to pay for the real-time purchases that the ISO makes to satisfy Edison's net short position. As explained in Mr. Detmer's declaration and in the comments that DWR filed supporting the May 11 Compliance Filing, the ISO in fact is doing so. Edison's preference that the bill for these purchases go directly to DWR is not required either by the ISO Tariff or by anything in the Commission's Orders.

To the extent Edison is arguing that the ISO must obtain credit support from DWR or another entity for all Energy required to meet Edison's net short position, that argument, too, is groundless. The Commission recently confirmed that its requirement for assurances of payment by a creditworthy entity is not equivalent to a requirement that Energy be purchased to meet all Demands regardless of the price at which it is offered. DWR, which, as a public entity is not subject to the Commission's jurisdiction, remains free to exercise 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.[9] To the extent that DWR or

[9] *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).

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 Edison's and PG&E'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.

B. The Commission's Credit Support Orders Do Not Relieve Edison of Its Financial Responsibility for Energy and Services Procured On Behalf of Its Customers

Edison claims that the Commission's orders on credit support 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, Edison contends that the fact it no longer satisfies the creditworthiness provisions for Scheduling Coordinators and Utility Distribution Companies relieves it from all obligations under its 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.

It must be recalled that the ISO's initial filing of Amendment No. 36 -- which gave rise to this docket -- was intended to assist Edison and PG&E

through what was hoped to be a short-term financial difficulty. Both Edison and PG&E generally supported Amendment No. 36.[10] 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 Edison's End-Use Customers because PG&E and 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 Edison and PG&E. Thus, the April 6 Order states that "[f]or transactions involving third-party suppliers," the Commission requires "a creditworthy counterparty, such as the California Department of Water Resources (DWR)."[11] More recently, the Commission again made it clear that its orders require only a creditworthy party to provide "assurances of payment" for purchases made to meet the Demands of customers for which Edison and PG&E remain responsible:

> 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.

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[10] *See* 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").

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

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

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

Edison's liability for Energy and services procured on its behalf and on behalf of its customers also is mandated by California State law establishing that IOUs have the obligation to provide reliable electric service to their customers. As noted above, AB1X authorizes DWR to purchase energy for the "net short" power requirements of Edison and PG&E, *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 - that portion of existing retail rates that equals the 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 [DWR] 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 Edison and PG&E retain their primary responsibility to provide service to the customers in their service territory.[12] Thus, the other provisions of AB1X that indicate that retail end users are deemed to have purchased the power from DWR, that payment for any sale is a direct obligation of the retail end user to DWR, and that DWR retains title to all power sold by it to retail end-use customers[13] properly are 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.

This spring, the CPUC reaffirmed the primary obligation of Edison and PG&E 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

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[12] "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).

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

> 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, Edison remains financially responsible for Energy and services procured on its behalf under AB1X and that legislation provides a mechanism by which suppliers can receive payment for such services.

Finally, as noted earlier, Edison's responsibility for Energy and services procured on its behalf arises not only from the ISO Tariff and state law but also from an interlocking mosaic of contracts that Edison has 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 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 is 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, Edison has not initiated the appropriate steps to relieve them of their liabilities or justified such a step.

In sum, there is no justification for 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 reject the arguments of Edison on this issue.

C. The Demands of Edison's Customers Continues to Show Up On the ISO System

Despite Edison's lack of creditworthiness, and its preference to cease receiving invoices from the ISO, the Demands of its Customers Load continue to show up on the ISO system. This existence of this Load requires the ISO to procure Energy and services for Edison customers, as long as it obtains "prior assurances of payment" from DWR or another creditworthy entity. Only if Edison were to discontinue allowing this Load to appear on the ISO system by implementing Demand response programs or through other measures, would the ISO be able to cease providing it with Energy and services, obviating the need to invoice Edison for the costs.

III. CONCLUSION

For the foregoing reasons, the Commission should deny as moot Edison's Motion of June 7, as the ISO already is in full compliance with the Commission's orders on creditworthiness.

Respectfully submitted,

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Dated: June 22, 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 22nd day of June, 2001.

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Julia Moore
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June 22, 2001

Daniel Larcamp
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Via Hand Delivery

Re: California Independent System Operator Corp.
Docket No. ER01-889-006

San Diego Gas & Electric Company, *et al*.
Docket No. EL00-95-036

Dear Mr. Larcamp:

Roger Smith asked me to pass along a copy of this filing, and to let you know that the attachments supporting it contain the market notices for which he heard you were looking.

Sincerely,

Julia Moore

Counsel for the California
Independent System Operator Corporation