



# Payment Acceleration Whitepaper

Version <1.2>

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**Revision History**

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4/27/04	1.1	Modifications based on group	C. Snay
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## Overview

### 1. Executive Summary

The California ISO (CAISO) payment calendar poses unacceptable credit risk to market participation. This increased risk hinders resource availability from out-of-state resources, complicates credit management, and exposes market participants to unacceptable risk in the event of defaults or bankruptcies.

The CAISO proposes to implement payment acceleration to address all of these issues, sometime late in 2005. Payment acceleration would initially provide market clearing 20 days after the end of a trade month, consistent with practice across the western energy markets. While it addresses the credit risks and long-standing complaints from Scheduling Coordinators (SCs) it also requires changes by load servicing entities regarding meter data submittals and estimation. These will be identified and addressed as the project progresses. Payment acceleration opens the possibility of other significant improvements. The CAISO will also explore with participants opening the dispute window and implementing a sunset provision for disputes as part of this Payment Acceleration Project.

It should be noted that payment acceleration is being used at other ISOs to reduce credit risk. PJM and NYISO have payment periods approximately half the CAISO, and they were recently ordered by FERC to explore further payment acceleration to reduce credit risks in their markets.

#### 1.1 Background and Problem Definition

The CAISO currently clears payments and credits approximately 80-85 days after a trade date. For example, the trade month of January is currently invoiced and paid in mid-April. This extended clearing period, which is significantly longer than that of any other ISO:

- Creates substantial incremental credit risk, which increases both the probability and magnitude of default and bankruptcy by and for participants in the ISO markets
- Complicates the management of credit security for the CAISO and SCs
- Has negatively impacted participation by out of state resources that have used the western standard of payment of 20 days after a trade month in their business.
- Has been criticized by various SCs every year in the Client Satisfaction survey since start-up in 1998.



Each of these issues is explored in more detail below.

### **Credit Risk Management and Security:**

The current payment calendar defers settlement of market charges for 85 days. This is longer than any other market and poses unnecessary risks of defaults or bankruptcies to the market. Earlier financial clearing will make the market more liquid, which will put downward pressure on prices overall. We noted that the current payment calendar increases both the probability and magnitude of default and bankruptcy by and for participants in the ISO markets. This risk is borne by participants on both the debit and credit side of the market. Market creditors are required to function as “banks”, financing the often financially stronger load side of the market, further complicating the often-tenuous financial position of various market participants.

Further the method of the calculation of credit security dictates that a SC must post three months worth of credit with the CAISO in order to participate in the CAISO’s markets. Payment acceleration would significantly reduce required security requirements.

Also with payment acceleration, resources will not find it necessary to add either the cost of money or credit risk adders to prices bid into the markets. While such additional costs are not currently as explicit as the ten percent credit risk premium that FERC applied to the CAISO energy markets during and after the 2000/2001 energy crisis, the higher cost of funds must be recovered and included in energy prices by suppliers.

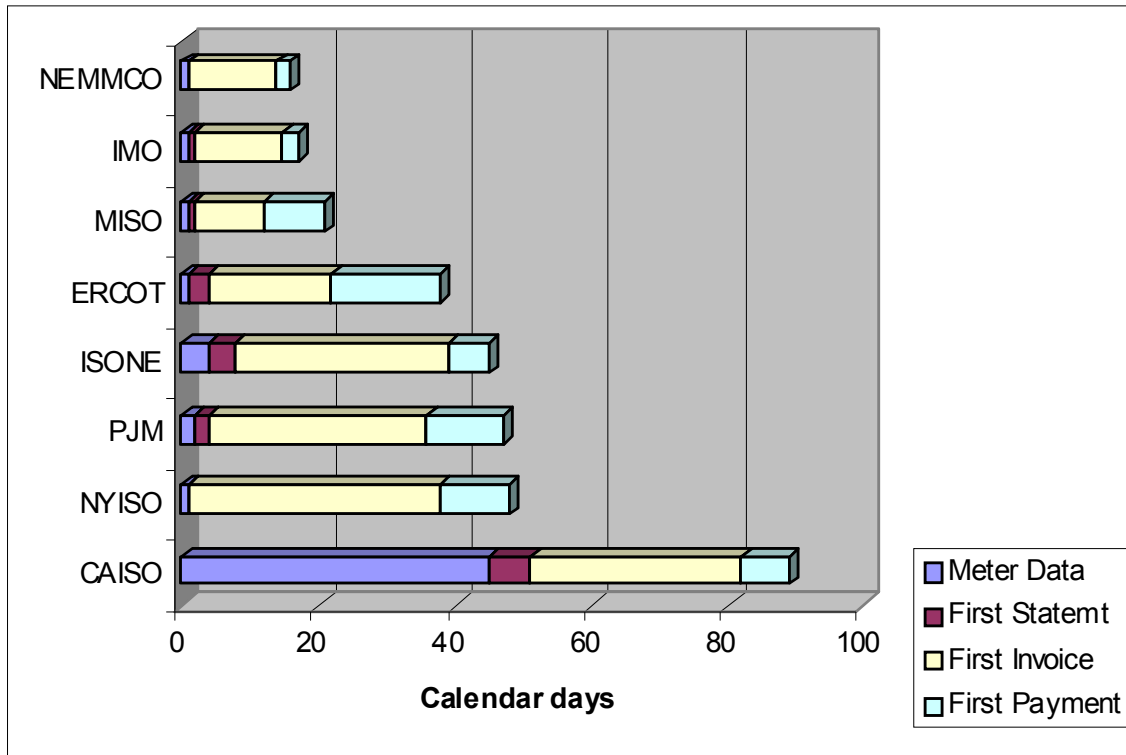
### **Resource Availability and Consistency with other Western contracts:**

Standard practice for payments throughout the west has been 20 days after the end of a trade month. On some occasions, out-of-state resources have notified the CAISO that available resources were being sold elsewhere in the west where payment terms were better. This has had some impact on availability of resources. This could also impact market-clearing prices.

### **Comparison with other ISO/RTO’s:**

The picture below depicts the CAISO payment dates compared to other ISO/RTOs.

NYISO and PJM were ordered by FERC to report in April 2004 on how they would reduce credit risk through payment acceleration. They are looking at weekly invoicing to accomplish this. Similarly, NEISO will begin weekly invoicing on June 17, 2004.



**Settlement Timeline:**

The introduction of payment acceleration would also provide a unique opportunity to modify the CAISO settlement timeline, including dispute windows and dispute sunset provisions. Several SCs have voiced a desire to revise the dispute timeline. Initiating such discussions will provide the CAISO with the opportunity to also introduce a Sunset Provision into the CAISO Tariff, reducing uncertainty to both the CAISO and market participants.

With the advent of a new CAISO settlement system, further refinements can be made to easily perform settlement true-ups similar to other ISOs, versus the time-consuming reruns now required.

**1.2 Expected Outcome**

The ISO expects that the payment acceleration project will produce the following outcomes:

- Invoices for payment 20 calendar days after the end of a trade month (or earlier)
- Settlements statements 2 weeks after a trade date
- A credit run by the CAISO 1-2 days after a trade date, available to SCs
- Improved dispute window and sunset provisions



The CAISO expects that the change will be viewed favorably by market creditors (typically suppliers) and initially with concern by market debtors (typically load) due to the potential for additional work and the need to pay bills sooner. The CAISO will initiate discussions first with Load Serving Entities to clarify and address their issues. However, for market debtors, the proposed change should provide advantages as well, including reduced energy prices, reduced security posting requirements and additional flexibility on the dispute window and meter data submittals.

It should also be noted that payment acceleration would not be feasible until the implementation of a new settlement system, which is currently under development by the CAISO.

## Conceptual Overview

## 2. Conceptual Overview

### 2.1 Conceptual Overview

The conceptual overview of payment acceleration includes the following areas:

- For meters that aren't automatically polled, SCs will submit measurement file at Trade Day (T)+5 business days
- The new payment calendar will be comprised of five statements:
  - o Initial statement at T+9 Business Days
  - o Meter data submittal deadline
  - o 1<sup>st</sup> True up (replacing preliminary statement)
  - o 2<sup>nd</sup> True up (replacing final statement)
  - o Subsequent true ups at perhaps 12 and 24 months after a trade date to permit meter data corrections that now force major reruns
- Invoicing
- The above schedule would provide for a monthly invoice approximately 2 weeks after the end of a trade month and payment receipt and distribution 20 days after the end of the trade month.
- Invoicing subsequent to the initial invoice, could be made at all true ups.
- Weekly invoices could be implemented in the future, so the CAISO is preparing for this eventually and suggests participants also prepare.
- It may make sense to exclude certain charge types on initial statement:
  - o Uninstructed Deviation Penalty (UDP)
  - o Metered SubSystems(certain charge types only)
  - o Wind (certain charge types only)
  - o No Pay

### 2.2 Sunset Provision

A long-standing issue in the CAISO tariff is the total lack of a sunset provision. As an example, the recent rerun included meter data changes that were six years old. The CAISO proposes establishing a firm sunset provision coincident with the payment acceleration change. Advantages include:

- Increased certainty in financial settlements
- Reduced data retention requirements
- Simplified credit security requirements for entities leaving the market.





### **2.3 Project Schedule**

The following is an outline of the proposed payment acceleration schedule:

- May-June 2004 – Initiate Stakeholder meetings with Load Serving Entities (LSEs)
- June-July 2004 – Incorporate LSE inputs and present to all SCs
- August-September 2004 – Governing Board approval and FERC filing
- Late 2005 – Implementation

## Benefits of Payment Acceleration

### **3. Benefits of Payment Acceleration**

#### **3.1 Benefits of Payment Acceleration**

The potential benefits of Payment Acceleration include:

- Increased liquidity and reduced accounts receivable carrying costs for generators
- Reduction of risk premiums in energy prices
- Reduction in security costs to buyers
- Increase in inertia participation in the market
- Consistency with other ISO's and Western Energy Markets
- Reduction in risk associated with SC failures and bankruptcies, and the negative effects such events can have on overall supply and market stability.